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TRADE AND COMMERCIAL LAW ASSESSMENT – COSTA RICA

FINAL REPORT



January 2005

This publication was produced for review by the United States
Agency for International Development by Booz Allen Hamilton

UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT



Trade and Commercial Law Assessment Costa Rica

FINAL REPORT

December 2004

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Contract No. PCE-I-00-98-00013
Task Order No. 13 The Seldon Project

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I. EXECUTIVE SUMMARY

If there is one word that captures the state of the legal and institutional environment for commercial activity and trade in Costa Rica, that word is, arguably, “ambivalent.” On the one hand, Costa Rica has a rich heritage of stable, democratic institutions, along with a modern ethos of investor friendliness. Its legal framework in most areas (with some notable exceptions) is adequate, and the country sets an important example for the region in trade promotion and support of competition among businesses. On the other hand, for a country with such a strong consciousness of the benefits of foreign investment, free trade, and development of modern laws, Costa Rica seems to be dragging its feet in certain critical ways. Expensive, state-run monopolies undercut advances toward genuine competitiveness. Exaggerated concerns over procedures undermine the effectiveness of otherwise viable institutions. Furthermore, most companies are run with an absence of transparency, the very practice of which would increase their attractiveness to potential investors. A new resolve to release certain legal constraints and engage in meaningful reform of vital institutions would allow Costa Rica to rise to the next level of economic freedom and development.

At the request of the United States Agency for International Development (USAID), Booz Allen Hamilton conducted a Commercial Legal and Institutional Reform (CLIR) and Trade assessment in June 2004 to analyze strengths, weaknesses, and opportunities for change in Costa Rica. The assessment was conducted by a four-member team of legal reform specialists as one part of a five-country Central American regional assessment.¹ This report presents the team’s findings and recommendations directly pertaining to Costa Rica, through in-country interviews conducted in May 2004 and further research. A report prepared for the region will address common issues in trade development and CLIR, along with regional approaches to reform and development in these areas.

This report first identifies various commonalities in the CLIR and trade environment in Costa Rica that may be incorporated into a reform program on a cross-cutting basis. The key lies in working through the country’s institutional ambivalence. As discussed in the next section, CLIR and trade programs can specifically respond to the recalcitrance, fear, and misunderstanding that impede economic growth through (a) significantly strengthened standards and practices of professionalism throughout the CLIR-related communities; (b) more and better information from public institutions and private companies; and (c) improved institutional accountability, particularly through the use of technology.² Second, the report examines 13 subject-matter areas identified for assessment by USAID, analyzing each from a four-part perspective: Framework Laws, Implementing Institutions, Supporting Institutions, and Social Dynamics. The general findings are summarized as follows:

- ♦ ***Company Law.*** The legal underpinnings of company formation and operation in Costa Rica are generally sound, although far from perfect. The principles of corporate governance, however, are not well observed, such that “inside dealing” is endemic within

¹ The five countries examined as part of the regional assessment are Costa Rica, Guatemala, El Salvador, Nicaragua, and Honduras.

² Some of the information that pertains to such cross-cutting themes is repeated throughout in different sections of the report so that interested reader may focus more clearer on a specific area.

closely held corporations and minority shareholders are poorly protected. The economic implications of this corporate governance deficit are grave. A notorious aversion to risk held by investors in Costa Rica is likely attributable to the typically closed operations of most companies, the great difficulty in obtaining reliable information, the presumption of inside dealing among company owners, and unreliable accounting practices within closely held companies. Thus, a new and resounding emphasis on corporate governance is called for in Costa Rica.

- ♦ ***Contracts.*** The legal framework for formation of traditional types of contracts in Costa Rica is clear. The main problems concern certain overly formalistic bureaucratic requirements that increase transaction costs and delay the process of conducting business, as well as the lack of a legal framework for modern contracts (e.g., leasing or electronic commerce). In addition, the lack of confidence in the courts to meaningfully enforce contractual obligations—secured or otherwise—substantially undermines economic activity.
- ♦ ***Real Property.*** Costa Rica's real property system is generally sound. The legal framework is mostly clear and coherent. The main problems arise from the registration procedure and the inconsistency between the legal information found in the Real Property Registry and the Cadastre. Although awareness of the problem exists and some changes are under way, bureaucratic hurdles hinder immediate reforms.
- ♦ ***Collateral Law (Secured Transactions).*** Costa Rica's law of secured transactions is inadequate to meet national and regional commercial credit needs. Although foreign investment in Costa Rica's industry and commerce has increased significantly during the last three decades, these investments, as a rule, enjoy their own sources of financing at affordable rates of interest. In contrast, small and medium-sized enterprises (SME) in Costa Rica have to pay interest rates of 25 percent to 30 percent per annum in their bank borrowings. If a loan comes from a private lender, the borrower may have to pay an additional 10 percent or higher. The scarcity of commercial credit and its high cost leads to self-financing out of limited savings and thus to less economic development than reasonable rates of interest would enable.
- ♦ ***Commercial Dispute Resolution.*** Significant legal and institutional improvements to the system of commercial dispute resolution in Costa Rica would remove considerable restraints on economic activity. The courts in Costa Rica are overburdened, slow, and inefficient; most judges do not have a particularly strong understanding of modern commercial issues, and over-reliance by judges on procedural formalism undermines the intent of commercial law; alternative dispute resolution (ADR) is underappreciated as an important vehicle for facilitating commerce; corruption undermines public confidence in the system; and enforcement of judgments is highly problematic. Given the overwhelming extent of the problems, a program of court reform for the purpose of bolstering economic activity would have to make difficult decisions about priorities and accept that full-scale reform might take a generation.
- ♦ ***Bankruptcy.*** The virtual absence of a functioning bankruptcy system in Costa Rica represents a missed opportunity of economic significance. Although Costa Rican bankruptcy law provides for liquidation, the dearth of officially sanctioned bankruptcies

means that the country is failing to achieve the benefits of fair and efficient dissolution. Moreover, Costa Rican law does not directly provide for the type of “rehabilitation” or “workout” procedures that are found in Chapter 11 of the United States Bankruptcy Code. Thus, Costa Rica is missing an important opportunity to enable some companies to return to viability and even profitability. This situation would likely be improved through strengthening of the existing legal framework, including better reconciliation of bankruptcy law with other commercial laws, and greater education of judges, lawyers, and other professionals about the theoretical and administrative aspects of a sound bankruptcy regime.

- ♦ **Competition Policy.** Costa Rica has had a competition law for about 10 years and thus has exhibited the strongest institutional commitment to competition in the region. The implementing state agency for competition, along with elements of the private sector, has had some impact on a legal-political culture not yet committed to free and open competition. The overwhelming problem with respect to competition in Costa Rica is the intransigence of state monopolies. Costa Rica’s unrelenting maintenance of these monopolies in such sectors as electricity, telecommunications, and insurance is a consistent drag on the economy because the country continues to be burdened with debt from an unsustainably large public sector. Building a public consensus concerning the desirability of breaking down these monopolies might begin with a thorough analysis of the direct economic costs to the country of maintaining these monopolies.
- ♦ **International Trade.** Costa Rica can be considered a regional leader with respect to seizing the opportunities inherent in opening up to regional and international trade. Although the legal framework and implementing institutions for international trade are generally sound, the effectiveness of Costa Rica’s trade regime could be improved through better training of officials charged with implementing the laws, including the judges, regulators, and the Customs Service; improvement of other commercial laws that would support the trade environment (in particular secured transactions); and, to the extent possible, additional resources devoted to trade-related institutions.
- ♦ **Flow of Goods and Services.** For the most part, the laws that govern the institutions and operations of the flow of goods and services provide adequate authority. One critical element in national efforts to improve Costa Rica’s competitiveness is the Customs Competitiveness Program. This program involves the reorganization of Customs to promote efficiency and the free movement of goods. Customs’ own 5-year plan, which includes these same objectives such as reorganization to better meet the needs of a modern Customs Service, has been initiated. Moreover, Customs has identified the requirements for full integration in the Central American Customs Union. However, questions of national sovereignty, allocations of collected revenues, and lack of political will have delayed Costa Rica’s participation in this effort.
- ♦ **Flow of People.** Overall, the efficiency and security of people flows in Costa Rica is adequate. The system supports contemporary methods for processing business-related travel that facilitates entry and exit at low administrative burden and cost. Illegal people flows are an issue for Costa Rica, however, because of its relatively high level of development in the region. It is estimated that 1 million Nicaraguans live in Costa Rica. Furthermore, Costa Rica is a transit country for illegal migration to the north.

- ♦ ***Financial Crimes.*** On the one hand, Costa Rica's 30-year experience with prosecuting financial crimes represents an opportunity for the other Central American Free Trade Agreement (CAFTA) countries to benefit from its lessons learned. On the other, the system could be significantly improved through more resources and up-to-date laws to investigate and prosecute a growing amount of fraud and money laundering. In addition, stock and investment fraud against foreigners (those living abroad and in Costa Rica) is widespread. The Judicial Police and Prosecutors often overlook this problem, thereby undercutting the environment for investment in Costa Rica.
- ♦ ***Flow of Money.*** Overall, the efficiency and security of trade-related money flows in Costa Rica are quite strong. The banking system offers contemporary methods for traders, and there is a well-developed market of banks that offer the appropriate banking and finance tools.
- ♦ ***Supporting Infrastructure for Trade.*** Costa Rica's trade infrastructure suffers from systemic negligence in maintenance and expansion. Infrastructure development has been outpaced by demand during the past decade. Although not quantifiable, the costs associated with continued operations under existing conditions will hurt Costa Rica's competitive position in the marketplace. Costa Rica requires focused investments in infrastructure to facilitate trade. Of particular importance are overland transportation facilities (i.e., roads and rail). To expedite implementation of infrastructure improvements, Costa Rica should consider the advantages of private sector investment through concessions, public-private partnerships, or other private sector involvement. Currently, public resources are scarce and projects are subject to delays because of financial pressures and variable prioritization resulting from changes in administration.

II. CLIR AND TRADE IN COSTA RICA: CROSS-CUTTING THEMES

A. THE FOUR-PART ANALYSIS

The four-part analysis of the 13 subject-matter areas addressed in this report not only allows for a multidimensional understanding of specific CLIR and trade-related challenges but also creates the basis for certain general themes to emerge. The analysis consists of the following:

- ♦ **Legal Framework.** The assessment first examines the laws and regulations that a country has in place that serve as the structural basis for its ability to achieve market-based development. Often discovered through this review are opportunities to make relatively small changes that may result in significant openings for business development and expansion.
- ♦ **Implementing Institutions.** Next, the assessment examines the administrative bodies with primary responsibility for implementation and enforcement of the legal framework and subsidiary laws, regulations, and policies governing one or more areas addressed in this report. For example, courts are usually a crucial institution in the examination of CLIR. Here, problems uncovered often relate to bureaucratic inefficiency, lack of resources and training, and real or perceived corruption. With respect to the flow of goods, services, and people, Customs and Immigration authorities are the chief implementing institutions.
- ♦ **Supporting Institutions.** The assessment then considers the environment of firms, individuals, or activities without which the legal framework or policy agenda cannot be fully or efficiently developed, implemented, or enforced. Examples include notaries, bailiffs, trustees, banks, consumers groups, business support organizations, professional associations, and other similar ancillary service providers. Of particular interest with respect to supporting institutions is whether they have any meaningful involvement in *what the law says*. Where a “buy-in” from affected constituencies has occurred, a law is more likely to be understood, to be used properly, and to achieve its purpose.
- ♦ **Social Dynamics.** Although the first three dimensions of the assessment examine *what* is present or lacking in the CLIR and Trade environment, this fourth area for review looks at *why*. Studying social dynamics entails asking whether the affected constituencies of a law or policy perceive a need for change, and, if so, how they are demonstrating this need. Are they effectively lobbying those institutions that can make a change? Is the media seizing the issue as a topic of public concern? Are individuals speaking out? Or, have social dynamics taken a less positive approach—for example, is the “gray economy” growing as a response to over-burdensome conditions for market entry? Are companies and individuals simply paying the bribes, large or small, that are asked of them rather than seeking action from higher authorities? Analysis of social dynamics may affect how an assistance project is ultimately designed. Where outside participation is strong and public understanding high, a reform program may simply involve a relatively small number of government officials who are capable of meeting the demands. In contrast, where mistrust and misunderstanding are abundant, an approach that involves significant engagement of “end users” will likely be necessary.

B. NEEDED: IMPROVED PROFESSIONALISM, BETTER INFORMATION, AND MORE ACCOUNTABILITY THROUGH TECHNOLOGY

Against this backdrop, certain cross-cutting themes emerged with respect to CLIR and Trade in Costa Rica. It is important to consider and incorporate these themes, but not necessarily through stand-alone initiatives. Rather, it would be prudent to address these cross-cutting themes within the context of any legal reform undertaken, as further detailed below.

1. Professionalism

Although there is no shortage in Costa Rica of trained, competent professionals, it is clear that individuals in positions of authority must be better challenged to make a more meaningful professional contribution. Common sense dictates that situations that are misguided, inept, or inappropriate should not be defended; they should be changed.

For example, in the areas of bankruptcy and collateral law, it was observed that case decisions written by judges regularly exhibit a rigid adherence to procedural formalism that ultimately complicates or obscures the framework for commercial activity, rather than clarifying or assisting it. Although the judges in these instances may succeed in dutifully expounding on the letter of the law, they often have failed to account for the laws' *purpose*, which—with respect to collateral and bankruptcy, in particular—is to guide individuals through various phases of their business. Although judges obviously cannot assume the law-making role of legislators, it is well within the international legal tradition for cases to solve problems rather than create new ones. At the very least, Costa Rican judges could be more mindful of calling attention to legislative deficiencies when they are forced to render a decision that obstructs future economic activity for prompt resolution by the Legislative Assembly.

Similarly, a degree of bureaucratic stagnation has emerged in certain institutions that are quite clearly capable of performing better. SUGEF, the institution responsible for managing insolvent lending institutions, has a policy of restricting “interventors” who oversee banks on the edge of bankruptcy to its own personnel. Yet, SUGEF has an undistinguished record of saving banks from liquidation or using creative means (e.g., combining institutions through “shotgun marriages”) to make new, improved lending institutions. Without the challenge of identifying qualified people who might handle the problem better, the mediocrity of this system is preserved.

In another instance, it is widely agreed that the Commercial Registry is badly in need of restructuring and technological improvements. Lack of financial resources is constantly mentioned as a cause for the Registry's problems. However, according to knowledgeable sources interviewed during the assessment, the Registry has funds in excess of \$1 million that are available and can be used to undertake reforms. An absence of leadership by people who are capable of doing more seems to be at the crux of the problem.

The Customs Service holds another example of bureaucratic inefficiency that warrants prompt attention and meaningful action. As a result of interviews conducted during the assessment it was learned that sixty Customs officers are assigned to Puerto Limón, including technical and administrative personnel, whereas 120 officers staff the airport. Yet 80 percent of international trade transits through Limón. To demonstrate the impact of staffing inequalities, import cargo at

the northern land border post of Peñas Blancas is usually released within 1 hour after presentation of the documents to Customs, whereas the standard for Limón is two days. To the extent that labor union influence is at the heart of this problem, those unions must be drawn into the national conversation about trade promotion in Costa Rica.

Moreover, throughout the assessment process, corruption was cited not as an overwhelming, systemic problem that permeates all levels of commercial activity but as a more subtle aspect of the business process that persists at a low but constant and pernicious level. Effective efforts to root out speed money or unsanctioned processing fees in certain institutions (e.g., Registries, the Customs Agency, or even the courts) should be launched. Costa Rica has the capacity to identify and prosecute individuals engaged in corruption; more aggressiveness in doing so at the lower levels would send a message to all affected groups that such interference with the business process will not be tolerated.

Why do people and institutions stagnate, procrastinate, avoid confrontation, or obstruct? Often, the answer lies in either fear of proposing and standing behind meaningful change or fear that the proposed change might fail. Or, resentment over a perceived overabundance of foreigners or other reservations about foreign influence might be the issue. Costa Rica's failure to effectively prosecute widespread fraud against foreigners is an example of how ambivalence over foreign investment may undermine the national economy and in fact drive investment away. Programs of assistance should directly speak to these issues and examine what can be done to alleviate them.

There are various means that reform programs can use to confront and address tendencies toward stagnation or institutional ambivalence, including programs that underscore the true meaning of professionalism. Namely, professionals from all dimensions of the CLIR and Trade communities could be encouraged to view their work as not simply a series of procedures to follow but as an opportunity to solve problems, serve the public, and make a difference. Through strengthened professional organizations, improved access to and quality of continuing education, collective development of codes of conduct, and increased public understanding of what they are entitled to expect, Costa Ricans in positions of authority can be encouraged to do better. Similarly, in the private sector, successful business leaders should be challenged to set an example for improved systems of corporate governance through better accounting practices, more efforts at transparency, and stronger protections of minority shareholders.

Although Costa Rica boasts a highly competent workforce, there is significant room for improvements that would increase the knowledge base of professionals and therefore guide them toward better service and stronger performance. As detailed in this report, the system of educating lawyers is in great need of reform. Increasing the standards for entering the profession would likely result in fewer lawyers but, in turn, more effective and efficient representation. Judges require significant continuing education in areas pertaining to commercial activity, particularly with respect to modern types of commerce and newer laws, such as the competition law, potential laws pertaining to modern contracts or electronic commerce, and laws concerning money laundering. In addition, within almost all of the implementing agencies related to CLIR and Trade, such as the Customs office or the consumer protection agency, more and better training was identified as a need.

2. Information

There is a severe shortage in Costa Rica of the kind of information needed for facilitating rapid, trustworthy economic activity. Because of the virtual absence of principles of sound corporate governance, the available information specifically pertaining to businesses and investment in Costa Rica is perilously opaque. In addition, sources of information that state institutions should supply with reliability are not effectively maintained.

Examples of the poor supply of information are as follows:

- ♦ For the majority of corporations, which are closely held, an accountant trained in International Accounting Standards is not responsible for the substance of the information included in the company's accounting records. Rather, the accountant typically sets forth the information as provided by the company's administrators with no independent judgment. Thus, investors rightly lack confidence in most of the financial information available from the companies.
- ♦ The National Registry of Costa Rica maintains databases of information such as debtors' defaults, company insolvency, and adverse lawsuits. Although the National Registry has sold its data to private firms in the past, it has suspended such sales until the Congress enacts a law determining the lawful uses of this information. In the meantime, access to this important information is difficult.
- ♦ With respect to the property regime, there is significant inconsistency between the legal information found in the Real Property Registry and the Cadastre. This creates numerous problems, such as difficulties determining the size, value, and boundaries of property and double title.
- ♦ Because no integrated IT system exists for all the regulating public agencies to track performance of either a company or product, reliable traders with a history of compliance cannot be identified for expedited treatment by the Customs agency.

The dearth of reliable information pertaining to the soundness of business enterprises and the authenticity of economic opportunities is a serious problem in Costa Rica. The opportunity for fraud against investors is significant. The chances of economic downturn when realities that had previously been concealed are revealed are increased. Thus, the law and legal institutions should be used in Costa Rica to improve information reliability and availability.

3. Accountability Through Technology

Certain of Costa Rica's trade-related institutions, including the banks and the Immigration Agency, use technology in a relatively up-to-date manner. Electronic money transfers and machine-readable passport machines are examples of important electronic updates that facilitate trade. The Customs Agency, though behind in its use of technology, seems at least to hold an understanding of what it needs to do to become current and anticipates improvements in the near term. Significantly, Customs officers reported that donating agencies have assisted by providing necessary technology but have failed to ensure that Customs officers receive the proper training on how to use the new systems.

Technology seems to be dramatically underutilized and misunderstood, on the other hand, in the commercial legal and institutional sectors. Although websites are proliferating as an information source, many government institutions that could provide helpful information to citizens, companies, and investors have fallen behind in the use of technologies that should be well within their grasp. For example, the Commercial Registry is partially automated; however, a significant amount of information is contained in written folders, and the process for transferring this information into computer databases is poorly managed and slow.

In particular, technology should be part of an overall strategic change in all courts. Access to legal information by court officials should be enhanced by automated mechanisms. The public should have access to updated information on existing cases, existing laws, and previous decisions. With better technology, accountability of all institutions will be improved. Opportunities for corruption are necessarily diminished when individuals have less opportunity for discretion over what is given and what is received.

III. COMPANY LAW

A. INTRODUCTION

Limited liability corporations are widely used in Costa Rica. The legal framework for companies is formalistic and thus is easy to use to avoid liability. However, to incorporate one is a tough time-consuming task. Often, companies are incorporated but remain inactive. Companies are often used to avoid application of the law in issues such as liability, legal restrictions, and tax evasion. In most cases, businesspersons, lawyers, and judges consider the limited liability of the corporations to be absolute and hence it cannot be disregarded. In summary, form prevails over substance in Costa Rica's company law.

Corporate governance principles are not well observed, providing minority shareholders insufficient protection. The Commercial Registry could be more efficient, but governmental restrictions on public expenditure impede improvements at present.

Although Costa Rica seems to be very attractive for foreign investors, the abuse of company law is undermining its appeal. In addition, the time-consuming registration procedure encourages development of the informal economy, which detracts from economic growth.

B. LEGAL FRAMEWORK

The Commercial Code sets the general rules for company law. It provides that various kinds of legal commercial entities, such as limited liability corporations—*Sociedad Anónima*—can be incorporated. Business owners commonly register as *Sociedad Anónimas* because this form shields individual shareholders from liability for the company's actions.

Companies must register with the Commercial Registry to be fully legal. Incomplete registration does not necessarily invalidate the existence of a company, but it makes shareholders liable to third parties. Thus, creditors of a nonregistered company can seize assets of the company and its shareholders. Registration requirements are good for the public in general and in particular to foreign investors who find protection against fraud by unincorporated companies.

The Law that Regulates the Stock Market governs companies that trade shares or bonds publicly. Publicly traded companies must obtain authorization of the Stock Market Superintendency before they may begin trading. Although very few companies trade shares publicly, some trade bonds publicly perhaps because of the size of the market and the weak stock investment culture of Costa Ricans. Consequently, the stock market is a "debt" market as opposed to an equity market. Functional equity markets are the ultimate protection from sustained abuse of majority shareholder power. If majority shareholders make decisions deemed unwise or contrary to the interests of minority shareholders, those minority shareholders can divest their shares. Underdeveloped and underused equity markets make shares illiquid, heightening the risk to prohibitive levels for small-scale investors.

The main authority of a *Sociedad Anónima* lies on the shareholders. They appoint the administrative body that in turn is supervised by the *fiscal* (external auditor). However, companies have little internal or external control. The internal control is very relaxed.

Accordingly, by law, a *fiscal* needs to be appointed. Although the duties of the *fiscal* relate to supervising the administrative body, in practice that supervision is rarely exercised. Often, the person appointed to be *fiscal* is either a shareholder or a relative of the administrators. Even though the appointment of relatives is prohibited, the practice occurs regularly. There seems to be no consequence, even if authorities learn that a relative is appointed as *fiscal*. Because most companies are family businesses, there seems to be no demand to enforce this rule.

The *Sociedad Anónima* is widely used for various commercial purposes. Although most of them are simply shell companies, many lawyers and judges consider their limited liability to be sacrosanct. Formalism prevails in company law. In labor law, the legal personality of a company can be disregarded, leading to liability for the corporation and shareholders in labor law suits, but only because the law provides so. Therefore, unless a statutory provision exists, the possibility of disregarding the legal personality of a company to make liable the controlling entity is rarely considered and vaguely known by the legal community at large.

The Commercial Code requires that accounting records be kept by a private accountant, not a certified public accountant (CPA). For that matter, bookkeepers are commonly used.

The accountant is not responsible for the information contained in the accounting records. In practice, the accountant includes the information provided by company administrators with no independent judgment. However, publicly traded companies are considerably more controlled. An external auditor must be appointed. Usually, external auditors follow international accounting standards.

Protection exists for minority shareholders, but the current level of protection is insufficient. Wronged minority shareholders can separate from the company and recover their capital at market value if not satisfied by the change of business or increase of capital. They also can request an independent audit and, in extraordinary cases, can call for a general meeting of shareholders. Usually, shareholders must have a significant percentage of shares before calling for meetings or approving relevant decisions. If they do not agree with the majority's decisions, they can leave; however, their shares would not necessarily be paid at market value. Limited minority shareholder protections, coupled with ineffective equity markets in Costa Rica, create very high levels of minority shareholder risk that cuts out smaller scale investors, limiting a source of private finance.

Shareholders cannot initiate legal actions on the company's behalf. If the company merges, the company resulting from the merger can initiate legal actions that belonged to the merged company.

Administrators are not personally liable for the company's deeds. Administrators could be responsible to the shareholders if they fail to comply with their duties.

Although Costa Rica's legal framework on companies allows investors to organize business, the framework is antiquated and being used improperly to avoid liability, encouraging wrongful behavior. This abuse of limited liability makes Costa Rica less attractive to foreign investors. Furthermore, the legal framework does not strictly enforce corporate governance. Poor protection of minority shareholders rights, coupled with an ineffective equity market,

discourages investment by small-scale investors. Excessive regulatory procedures for business startup cost many SMEs out of the market and results in a booming informal sector.

C. IMPLEMENTING INSTITUTIONS

1. Commercial Registry

The Commercial Registry is responsible for registering all companies operating in Costa Rica. Excessive bureaucratic hurdles make the procedure for registering a company extremely long and expensive. Occasionally, the final decision on registration is left to the discretion of the officer. It could take more than 4 months to establish a company using formal procedures. The total cost of registration was reported to exceed \$1,000, a considerable sum in Costa Rica. This figure is determined by the amount of the capital of the company.

As shown in Table 1, prepared by the World Bank, entrepreneurs can expect the process of registering a business to take **77** days, which is **7** more days than the regional average and **22** more days than the average business registration period of states belonging to the Organization for Economic Cooperation and Development (OECD).

Table 1. Process for Registering a Business

Nature of Procedure (2004)	Proc. No.	Duration (days)	US\$ Cost
Verify the company name	1	1	25.00
Send to Notary Public, which drafts and notarizes a public deed	2	1	547.06
Send the notice of the constitution for publication	3	1	0
Deposit 25% of paid-in capital	4	1	0
Register with Commercial Register	5	25	290.45
Register for tax	6	3	0
Legalize the company books	7	18	35.00
Apply for a Commercial Patent	8	18	200.00
Register as employer	9	7	0
Undergo an inspection conducted by CCSS	10	1	0
Register for labor risk insurance	11	1	0
Totals:	11	77	\$1,097.51

Source: World Bank

Company registration fees are set well in advance by announcements from the Registry. However, these fees are regularly changed at the discretion of the officer in charge. Notaries have complained about fees because their clients usually refuse to pay new costs. When new fees are announced, they apply to all similar cases. The excessive fees discourage local business from formal registration, reducing the government's tax base.

The Commercial Registry is partially automated. A significant portion of the information is contained in paper folders. Efforts are being made to transfer that information into electronic folders. Government restrictions on public expenditures make the understaffed Commercial Registry even less effective because new business growth creates greater strains on its resources. Thus, the Registry is undertaking two major tasks: automating the records while receiving growing numbers of new registrations. The Commercial Registry cannot cope with the current workload. At present, they have two workers shifts: one from 7:00 a.m. until 4:00 p.m., and another from 4:00 p.m. until 7:00 p.m. Even with this extra drive, however, it is still struggling to maintain current performance standards.

Access to Commercial Registry information by third parties is difficult. In addition, the information to be found therein is not always reliable because it is not updated.

Commercial Registry users perceive the system as slow, expensive, discretionary, obsolete, and slightly corrupt. Most cases of corruption take the form of “speed-money.”

2. Courts

The courts are empowered to handle cases involving companies such as bankruptcy, company audit requests, protection of minority shareholders, suits against the administrators, suits by and against companies, and enforcement of shareholders decisions or administrators resolutions. It is perceived that the courts do not deliver quick results.

As in the Commercial Registry, slowness, inefficiency, and slight corruption were reported to be present in courts handling company matters.

Although the limited liability of companies is considered virtual dogma and knowledge of the “lifting the corporate veil” doctrine is rarely known, some decisions have occurred in which the legal personality of the company was disregarded. For example, in a tax-related case, the Supreme Court disregarded the legal personality of a juridical person because in tax law the form cannot prevail over reality. Likewise, a trial judge disregarded the legal personality of a company in the context of a bankruptcy case and the entire economic group bankrupt.

Long and expensive registration procedures affect formalization of local business, which in turn affects economic growth. In addition, formalistic courts that do not consider the content of facts might discourage the flow of foreign business.

D. SUPPORTING INSTITUTIONS

Notaries are responsible for drafting the articles of incorporation of a company and filing with the Commercial Registry. Likewise, the notary should research the previous use of the name to be used and assets to be contributed, if any. The fees and costs of notaries are considered high. They are established in advance and determined as per value of the transactions; however, many notaries charge their fees at their own discretion. In many cases, the inefficiency of some notaries is considered to be the cause of part of the delay in the filing documents procedure at the Commercial Registry.

Accountants are incidentally involved with the *Sociedad Anónima*. In private companies (unlike public companies), CPAs are involved only when a judge orders a corporate audit.

Access to accurate and updated information about the status of companies (e.g., trademarks, bankruptcy, or company incorporation) is difficult. Although some private providers of that information exist, the cost of those services and the unreliability of this information make these service providers an inefficient resource.

A stock market exists where companies trade mainly bonds and other debt instruments. Although that market seems very modern, most Costa Ricans have little knowledge of the benefits of investing in stocks. Likewise, the risk culture required for equity market participation is not pervasive among Costa Ricans. A 3-percent loss was perceived as catastrophic and created panic among investors.

E. SOCIAL DYNAMICS

Pursuant to the Stock Market Law, corporate governance principles are imposed on publicly traded companies. In contrast, privately held companies rarely observe corporate governance principles. Among some civil society groups (e.g., chambers of commerce), a demand exists for stricter rules on corporate governance, particularly regarding banks. The government has exhibited no initiative in this area. This lack of corporate governance affects stock market growth.

Likewise, the formalized SMEs demand increase in protection to minority shareholders with legal reforms; however, no plan has been announced in that regard.

The Commercial Registry needs restructuring. The bar association, business associations, and the mass media, among others, are constantly pointing out the inefficiency of the Commercial Registry. Some temporary measures have been implemented, but a profound change is necessary. Lack of financial resources is constantly mentioned as a reason for the Registry's problems. According to interviewed sources, however, the Registry has funds available exceeding one million U.S. Dollars that can be used to undertake reforms. A restriction on public expenditure imposed by the central governments is a major obstacle to using those funds.

The majority of business in Costa Rica is handled by micro to medium enterprises. Often, some micro businesses are set up informally as a result of the excess of regulatory steps imposed to legalize them. Those steps are actual obstacles and can occasionally be overcome by larger enterprises, but not by micro business. Thus, the results are businesses organized outside the legal framework, with few opportunities to grow; in addition, these businesses do not pay taxes. In spite of a demand by SMEs for identification and removal of those obstacles, it is not happening. Lack of political will seems the reason. Likewise, there is demand for an agency devoted to promote business for the micro, small and medium enterprises, but there is no supply for it.

F. RECOMMENDATIONS

- ♦ Corporate governance principles need to be known. A training program devoted to training business people, lawyers, judges and governmental officials in this area seems crucial. As for judges and arbitrators, the program should address the issue of corporate personality as a flexible concept and the possibility of disregarding the legal personality. Likewise, many fraudulent cases are committed by companies that ignore the principles of corporate governance. Transparency and control can diminish this problem. Therefore, a promotional campaign regarding the existence of corporate governance principles, its benefits, and applicability to local companies should follow the training program. This campaign should target the society at large.
- ♦ Legal changes need to be passed requiring that corporate governance principles be followed and enforcement mechanisms be implemented. Likewise, protection to minority shareholders needs to be increased. Specific provisions should be included in the Commercial Code that would allow judges to disregard the legal personality of a company if the company was incorporated by its shareholders with a fraudulent intent.
- ♦ The Commercial Registry needs to be heavily reformed, and technology should play a crucial role in the process. Transfer of information from written folders to electronic format should be concluded promptly. Filing procedures must be transparent, quick, reliable, and less expensive. Strategic planning methodology and management tools should be introduced. Likewise, personnel should be trained. Public access to updated and accurate information is a priority. The central government must eliminate or increase the expenditure limit imposed on the National Registry.
- ♦ A diagnostic of the micro, small, and medium business situation is required. Some micro and small businesses are not legally organized; hence, little information about them is available. Furthermore, identification and removal of the obstacles hindering the growth of micro, small, and medium enterprise should be undertaken.

IV. CONTRACTS

A. INTRODUCTION

Generally the legal framework for formation of the contracts is clear and allows parties to enter into any kind of contract that does not violate the law or is contrary to public order. The main problem for contracts law is that the legal framework does not have all the provisions necessary for modern contracts, such as leasing and enforcement. Further, the procedures for contract enforcement are complex and lengthy.

Occasionally, special laws impose validity requirements to specific kinds of contracts. Validity requirements mostly relate to notarization of the contract to make it “public.” Those requirements increase the transaction cost and delay the process of conducting business. However, the special requirements do not apply to all contracts and cannot be imposed at the discretion of public officers.

Notary fees are considered high for local standards. Some businessmen complain about the need to use notaries to draft contracts.

Corruption is often mentioned as a problem in the context of not only contract enforcement by courts but also expediting the steps required for making valid or public certain kinds of contracts.

A lack of knowledge also exists with most lawyers, judges, and arbitrators regarding the contractual concepts used in modern international business.

Consequently, some changes are needed to foster the investment opportunities through a reliable and easy contract law system.

B. LEGAL FRAMEWORK

The Civil Code is the primary law for contracts. Other laws also are applicable to contractual situations where the parties are not common individuals or civil juridical persons. For example, the Commercial Code applies when one of the parties is a businessperson or a business entity; and the Law of Administrative Contracts when one of the parties is a governmental entity. Other laws, such as Insurance Law, govern various kinds of special contracts. However, the Civil Code is always the reference for the general issues of contracts. The Civil Code is a good reference for broad principles of contract law, allowing parties enough to create various kinds of contracts tailored to their specific needs. Freedom of contract also is provided by law and is highly respected, allowing lawyers to design contracts to govern *sui generis* situations.

Parties design new kinds of contracts that are not specifically regulated by the government. That is the case of the leasing contracts and the *factoreo* or factoring contract (i.e., commercial instruments and accounts payable sold at a discount). Some creative lawyers use existing legal tools to design contracts that cover of the needs of modern business, although no specific legal coverage exists.

Contracts are generally written and, in theory, oral contracts are allowed. However, parties seeking to prove the existence of an oral agreement are subject to difficult evidentiary

requirements. For example, witnesses may testify only if the amount in question is below a particular threshold.

If the contracts need to be interpreted, the judges are bound by the written word; however, they can use the *lex mercatoria* and their own judgment to determine the actual will of the contracting parties.

There is no legal provision applicable to electronic contracts, nor is there any draft bill. However, there is a draft bill on electronic signature and digital certificates in line with the international standards. Unfortunately, little legislative interest seems to exist in electronic contracts. Consequently, many electronic business agreements are left unregulated. Without adequate regulation of electronic contracts, risk-averse parties would likely be discouraged from electronic commercial activity.

A provision of the Civil Code (1023 d) states that contractual clauses that refer to foreign law for enforcement and interpretation of contracts can be annulled at the request of one of the parties. This provision provokes diverse responses from lawyers and judges. Some have argued that freedom of contract keeps this provision from superseding the will of the parties. Thus, if the parties agreed that a foreign law should apply, that agreement should be respected. Others considered the provision applicable only to prewritten non-negotiable contracts, where no bargain has occurred. One lawyer suggested that this restraint on choice of law—although legally binding—was not enforced and occasionally has been considered inapplicable by judges. However, this provision has not been legally repealed. Consequently, investors can be subject to Costa Rican law against the terms of their contracts. Because foreign investors usually prefer to have the capacity to select the choice of law, the limitation on choice of law creates a “disincentive” for commercial activity in Costa Rica, especially for foreign investors.

C. IMPLEMENTING INSTITUTIONS

1. Notaries

Contracts do not need to be registered to be valid, although some contracts must be notarized. Contracts requiring notarization are known as “public” contracts. They are primarily the powers of attorney and contracts for sale of goods and real property.

Notaries are more than support institutions for public contracts in Costa Rica. The notary is in charge of drafting the document, confirming the identity of the parties and certifying the authenticity of the signatures. Likewise, the notary is responsible for whatever the document states. If additional formalities were required (e.g., registration), the notary would perform those. Notaries incur liability when they fail to comply with their duties, or when they collude to commit fraud. Many businesspeople commented that, from a practical standpoint, notaries add unnecessary expense and time to the contract formation process, especially document drafting and presentation at the registry. Cutting notaries from these steps would reduce transaction costs and encourage additional contracts on the margin.

Notaries are regulated by special law and supervised by a special agency. Their fees are set by a special decree. However, notaries complain that unfair competition exists, requirements to

become a notary are flexible, and fees are too low. They also complain that judges do not understand notary law.

On the other hand, it is commonly perceived that notaries are expensive. Some foreigners believe that the notary is unnecessary and increases the transaction cost. Likewise, some foreigners have complained that a document notarized abroad, such as a power of attorney, is not valid in Costa Rica without passing through the lengthy procedure of legalization and must still be locally notarized. Costa Rica is part of the Inter-American Convention on Legal Regime of Powers of Attorney to be Used Abroad. However, notaries, judges, and lawyers said that a power of attorney granted in a signatory country would not be valid unless a Costa Rican notary notarized it. This seemingly violates the above Convention.

2. Courts

Courts are the primary institutions charged with contract enforcement. The procedure for enforcement has been criticized as extremely long primarily because of the inefficient and slow court system. It was reported that a decision awarded by a trial judge within a 3-year period could be considered a successful exception. There are no restrictions to appeal. The Supreme Court can also review the decision through the *casación* (Judicial Review), although in this case it could refer to only matters of law, not the facts. Extreme cases have languished in courts for more than 10 years until a final decision was reached.

Corruption, although not widespread, is increasing. Judges are not well paid. Some lawyers also perceive that judges are not well trained and lack knowledge of modern business concepts, foreign legal doctrine and jurisprudence, and tools for conducting economic and social analysis of law. For example, lawyers mentioned that some judges did not know that Costa Rica was a signatory of the United Nations (UN) Convention on the International Sale of Goods and did not know the content of that Convention, the general contract principles of the United Nations International Institute for the Unification of Private Law (UNIDROIT), or the International Commercial Terms (INCOTERMS) of the International Chamber of Commerce.

A draft Code exists that would transform existing civil procedures governed by the Civil Procedure Code from written to oral procedures. It is believed that the new Code will diminish the incentive for corruption while expediting the judicial process. However, the likelihood of that draft becoming law is uncertain because of political entanglements.

Table 2 lists how contracts are enforced and the relative efficiency of the court system.

Table 2. Enforcing Contracts

Nature of Procedure (2003)	Indicator
Number of Procedures	21
Duration (days)	370
Cost (% GNI per capita)	22.6
Procedural Complexity Index	86
General jurisdiction court	1.00
Professional versus nonprofessional judge	1.00
Legal representation is mandatory	1.00
Professionals or Laymen	1.00
Filing	1.00
Service of process	1.00
Opposition	1.00
Evidence	1.00
Final arguments	1.00
Judgment	1.00
Notification of judgment	1.00
Enforcement of judgment	1.00
Written or Oral	1.00
Complaint must be legally justified	1.00
Judgment must be legally justified	1.00
Judgment must be on law (not on equity)	1.00
Legal Justification	1.00
Judge cannot introduce evidence	0.00
Judge cannot reject irrelevant evidence	0.00
Out-of-court statements are inadmissible	1.00
Mandatory prequalification of questions	1.00
Oral interrogation only by judge	0.00
Only original documents and certified copies are admissible	1.00
Authenticity and weight of evidence defined by law	0.00
Mandatory recording of evidence	1.00
Statutory Regulation of Evidence	1.00
Enforcement of judgment is automatically suspended until resolution of the appeal	1.00
Comprehensive review in appeal	1.00
Interlocutory appeals are allowed	1.00
Control of Superior Review	1.00
Mandatory pretrial conciliation	0.00
Service of process by judicial officer required	1.00
Notification of judgment by judicial officer required	1.00
Other Statutory Interventions	0.67

Notes: 1- The Procedural Complexity Index for Costa Rica is **86**, compared with the regional average of **70** and the OECD average of **49**. Source: World Bank Doing Business in 2005, Honduras

2- Sub-index components are scored between 0 and 1, with 1 representing the highest level of complexity. The Procedural Complexity Index is constructed by averaging the six sub-indices and multiplying by 100. It varies between 0 and 100.

Source: World Bank

Inefficient enforcement of contracts is a growing concern in Costa Rica. Inefficient enforcement mechanisms have deleterious effects on the flow of foreign investment into Costa Rica, and therefore must be addressed.

D. SUPPORTING INSTITUTIONS

There is no legal obligation to notarize private contracts. In these cases, the notary is actually a supporting institution. Parties usually take those documents to the notary in the hope that its certification will decrease the likelihood of future litigation. Nonetheless, notaries are perceived as expensive, inefficient, and sometimes negligent.

Costa Rican law provides for Alternative Dispute Resolution (ADR) mechanisms for contract enforcement. Three arbitration centers exist with good reputations and supporting infrastructure. Contract disputes may be resolved through arbitration, so long as the parties consent either in the contract or after the dispute arises. Arbitration is efficient and fast compared with Costa Rica's courts. However, most Costa Ricans remain uninformed about ADR mechanisms available for contract disputes.

Some private publications advise the public at large of the courts decisions. Likewise, some publications are devoted to educating practitioners about local contract law. Model contracts also are published.

Though supporting institutions are frequently underutilized, as with arbitration, these institutions do exist. Steps should be taken to build on the strong supporting institutions in place in Costa Rica.

E. SOCIAL DYNAMICS

The government of Costa Rica lacks interest to pursue legal reforms in the area of contracts. Bills are valid for only 4 years. After that time, they need to be reintroduced to the Assembly or they will be considered to be withdrawn. The Legislative Assembly has not been responsive in areas where regulation seems necessary, such as leasing. The Legislative Assembly remains inactive in passing legislation on electronic signatures for contracts, and other modern contract standards.

Legal practitioners and the business community anticipate positive changes to the business environment once the Legislative Assembly passes the arbitration law and revises the civil procedure code. However, this legislation probably will not pass in the near term.

From the private sector, demand exists for reforms in the judiciary and notaries. Much of that focuses on eradication of corruption, proper functioning of courts, reduction of lengthy procedures, and updated regulation to notaries. That demand is not receiving the adequate supply from the government side, perhaps because of a lack of political will.

F. RECOMMENDATIONS

- ♦ There are more law schools than are necessary in Costa Rica.³ Some have bad reputations, and some have few or no courses pertaining to international business transactions. A major training program on international business transactions, economic analysis of law, foreign legal doctrine and jurisprudence, and electronic contract arrangements, is highly needed. Its main target should be practicing commercial lawyers. However, judges and arbitrators—mainly the former—should have customized training.
- ♦ New legislation pertaining to contract law should be enacted. The Commercial Code should address such topics as leasing, electronic contracts, and guarantees. Drafting and approval of modern laws that comply with international standards and reflect the Costa Rican reality should be encouraged.
- ♦ Likewise, a new civil procedure law that promotes oral and quick procedures should be promptly passed.
- ♦ Legal reforms should amend the arbitration law to allow foreign lawyers to serve as arbitrators, and allow the procedure to be handled in any business language, rather than restricting it to Spanish.
- ♦ The Court system needs to be reformed. Managerial techniques should be implemented to make their functioning more efficient. Technology should be part of an overall strategic change in all courts. Access to legal information by court officials should be enhanced by automated mechanisms. The public should have access to updated information on not only existing cases but also existing laws and previous decisions.

³ According to some lawyers there are more than 80 law schools. The World Bank indicators on legal and judicial reform report more than 22 law schools by the year 2000.

V. REAL PROPERTY

A. INTRODUCTION

Costa Rica's real property system is generally sound. The legal framework is mostly clear and coherent. The main problem arises from the registration procedure and the inconsistency between the legal information found in the Real Property Registry and the Cadastre. Although awareness of the problem exists and some changes are under way, bureaucratic hurdles hinder immediate reforms.

Zoning, squatter rights, and expropriation are reportedly typical problems. Some efforts are being made to diminish the impact that those problems might have in the business community. However, the solutions are not sufficient and the problems remain.

Long and uncertain judicial procedures further inflame existing problems. ADR mechanisms exist and are being promoted. However, Costa Rica's real property system still draws the criticism that "[p]rivate property is not entirely safe."⁴ Property protection is a vital component to any market-based economic growth and therefore these concerns must be addressed.

Currently, the key opportunities for real reform in Costa Rica's Property law lie in consensus-building, institutional assessment and strengthening, and judicial and legal reform.

B. LEGAL FRAMEWORK

Costa Rica's constitution explicitly respects property rights for all citizens and foreigners. The Civil Code is the foremost law in real property. It sets the general principles in this area. Under the Civil Code, individuals and companies alike are entitled to own, acquire, donate, use, rent, mortgage or impose any lien on any kind of real property. Real property is transferred by consent of the owner with no need to obtain governmental authorization. However, for title transfer to be valid between third parties, it needs to be registered.

More than 10 laws relate to issues of real property such as condominium, urban planning, cadastre, zoning, and expropriation. In 1995, a law on real property leasing was passed, allowing eviction of noncompliant tenants in a relatively short time period. It was reported that such law has helped on the development of the real property lease market.

Real property can be mortgaged; to be valid, the property needs to be registered. Real property registration is usually a slow process involving a notary and the Real Property Registry.

Zoning is reportedly a major problem. At least three different entities at various governmental levels have authority in this field. The municipalities and the urban and the tourism institutes are all empowered to determine how a property can be used by establishing restrictions of use per zone. In addition, the central government can establish restrictions of use of certain areas for environmental or safety purposes. Because Costa Rica has an established tradition of pursuing

⁴ Heritage Foundation, 2004 Index of Economic Freedom. Costa Rica was scored 3.0 in property rights. The score rank was from 1 to 5, with 1 being best, and 5 being worst.

environmental and ecological causes, some areas of the country have been declared national parks. Real properties composed within those parks have been expropriated directly or *de facto*.

When paid, compensation for expropriated property is often inadequate. Many cases have been reported of compensation disputes pending for more than 30 years. In one case, compensation was granted only after the owner was authorized payment before an international tribunal.

The expropriation law states that indirect expropriation needs to be paid. The Supreme Court has issued an opinion in which it stated that regulations tantamount to expropriation could remain in place only if compensation is paid. Lack of compensation would annul the regulation. Though the government rarely refuses to pay outright, compensation is often delayed, at below-market prices. An international arbitral panel recently held that a measure taken with the purpose of environmental protection that gradually deprived owners of the value of their properties over time was no different from a taking for which full compensation had to be paid.

In Costa Rica, the government is the main landowner. The government can grant concessions of use of its land, but cannot sell the land. The municipalities act as agents of the central government, granting land use concessions to private parties, and retaining the profit. That is the case of a big part of the beachfront property, which is widely untitled. Real property therein is governed by the Maritime Zone Law, which restricts the possession and ownership of beachfront property. Accordingly, the government owns the first 200 meters of beachfront starting at the high tide markers. Of the 200 meters, the first 50 are considered public zones, and nobody may possess or control that area. On the remaining 150 meters, the central government (through the local municipal government) will lease the land to private individuals. Local and foreign charlatans defraud foreigners through scams offering the sale of beachfront property because this property may not be transferred legally.

Squatters represent one of the greatest dangers to land ownership. Technically, squatters can only attempt to gain legal rights to non-maritime property by peacefully occupying the land over an extended time period. However, it has been reported that they do invade property. Likewise, it is not unusual for squatters to sell the premises on top of the land, but the Registry does not register those transactions. The government is aware of the problem. In some cases of squatter invasions, the government has bought the land from private owners and has then distributed it among the squatters. In absence of that purchase, the owners are provided with legal mechanisms to evict the squatters, but the courts are slow.

Real property is subject to a special tax supporting the finances of the municipalities. Information gathered through interviews pointed to the fact that the tax is relatively low (0.25 percent) and determined at market value. When the property is sold, it is subject to a transaction tax of 1.5 percent of the sale price. However, on top of the tax, there are other transaction costs (e.g., excessive notary fees). It was reported that total transaction costs amount to 4.6 percent of property value. Perhaps for this reason parties usually understate the property value. The lack of an effective cadastre makes accurate valuation difficult.

Although generally sound, Costa Rica's legal framework on real property can be risky for foreign investors. Issues such as indirect expropriations, uncompensated expropriations, zoning, squatters, and fraud can deter the flow of international capital.

C. IMPLEMENTING INSTITUTIONS

The Real Property Registry within the National Registry is the governmental entity with authority to register transactions related to real property, such as real property transfer, mortgage, and powers of attorney related to real property. More than 130 Real Property Registrars exist, all located in San José. National Registry officials indicated that although there are seven regional offices, they only receive documents and do not make official registrations of real property transactions. There are plans to decentralize the Registry, allowing regional offices to conduct official registrations as a part of the Registry's overall automation project.

The Registry follows the doctrine of first in time, first in right. Thus, recorded instruments presented therein are given priority according to the date and time in which they are recorded. However, the cadastre, the plat map of the property, is recorded in a different registry within the National Registry. The information of the Real Property Registry and the Cadastre Registry are not consistent. These inconsistencies create many problems, such as problems determining the size, value, and boundaries of property and double title. A senior officer at the Registry stated that if one accepts the information of the current Cadastre Registry, then Costa Rica would be three times its actual size.

When a transfer of property takes place at the Real Property Registry, the transaction may not have been recorded on the cadastre because a change in one does not automatically require a change in the other. It should not be assumed that the cadastre map accurately depicts the property. In many cases, an independent topographical study is conducted to verify the property boundaries.

The Real Property Registry now requires that parties to a land transaction present a map from the Cadastre Registry along with the property ownership transfer document to be filed. The problem is that the maps issued by the Cadastre Registry are usually the maps presented by owners and certified by topographic experts who in turn draw the maps as per the owners' instructions. This practice provides no check on the information supplied by the owners; thus, the information is often not credible. The Cadastre Registry needs to gather the topographic data separately to address this issue. The municipalities are much more independent and do not accept property maps that are not compatible with its regulatory plans.

Consistency between the information of the Cadastre and the Real Property Registries is being required at various levels. The banks have developed a practice whereby they do not grant credit guaranteed by a property if the map from the Cadastre Registry is not under the name of the purported owner. The Cadastre Registry in turn does not grant a map if there is a difference with the owner's name as recorded in the Real Property Registry. Likewise, the municipalities do not grant permit of use if the cadastre map is not presented or if the map has a name different from the owner's as recorded by the Real Property Registry. This overall situation affects the general access to credit because most lenders require real property as collateral.

The Real Property Registry is automated, although the Registry is slow when processing the information. Transactions are reported almost instantly through notes. However, the new owner, in the case of real property purchase, would not be identified in the official records for up to 22 days, as noted by interviewed officials. The third party has access to information proving the

legitimacy of the information and can act accordingly. Legally speaking, the property owner would be the person who appears to be the owner as per the Registry's records—not the one shown by the note. In other words, there could be a transitory period when the Registry could show one owner even though an agreement has been reached to transfer ownership. During that period, the Registry cannot file another transfer on the same property until it is cleared and the new transaction is officially recorded or until the note is eliminated. This transitory period creates a level of uncertainty that would affect investments in real property.

The Inter-American Development Bank commenced a project this year to certify the accuracy of data contained in the cadastre. Many expect that this process will take more than 5 years before full, detailed information can be compiled and can finally merge the data of the Cadastre with that of the Real Property Registry. In case of discrepancies between data contained in the Real Property Registry and the Cadastre, the information contained in the Cadastre related to size and boundaries will prevail. Once the information is raised and cleared, the two registries would be unified. However, even then another problem would remain: the owner could sue when the previous Real Property Registry data showed more land and the Cadastre shows less. That could create a judicial chaos, and further burden an already slow judiciary. An option for solving this could be to pass a “show-up or shut-up” law in which owners are given a time to complain; however, if they fail to do so, the information of the Cadastre would be incorporated into the Real Property Registry.

Another problem has to do with corruption at the Registry. It takes many forms. One is “speed money” corruption. Another is the “database” corruption that entails changes in the Registry's records about the owner, encumbrances, or size of the land. About 25 Registry's officers were dismissed last year as a result of involvement in corruption. According to Registry officials, the scope of discretion attributed to certain decisions the registrars can take is reported as a possible cause for corruption.

Registrars are required by law to obtain an insurance policy to guarantee users that they would be compensated if damaged by the negligence of the Registrar.

Court cases dealing with real property ownership are typically protracted and costly. According to one report, “In Costa Rica, a civil law suit will typically last up to 6 years....At the core of the Judiciary's problems lie an outdated set of administrative procedures and lack of resources.”⁵ ADR mechanisms are an option, but ADR is subject to agreement by both parties. Arbitration is increasingly used to settle local disputes, though it is still a relatively unknown practice, and can be expensive by local standards.

D. SUPPORTING INSTITUTIONS

Notaries are required for all real property transactions. Notaries draft the documents, research encumbrances, and file the transaction with the Real Property Registry. Their costs are reported to be relatively expensive. The Registry attributes part of its problems to the lack of control of the notaries, their ignorance of real property law, and the excessive number of notaries

⁵ The Economist Intelligence Unit on Costa Rica, 2003

nationwide. In some cases, it has been reported that the delay in the Registry arises from notary negligence, especially in amending the errors detected after the initial filing.

According to interviews, notaries have eight days after the transaction has been concluded to file the real property transaction with the Registry. Until the transaction is presented at the Registry, another notary can file a different transaction. Thus, in some cases, two property sales can be notarized but only one could be registered, a significant source of fraud in real property law.

An arbitration center exists specializing in real property matters. This center acts rapidly and has a good reputation. In some cases, the government has been party to the disputes and has consented to arbitration. That has occurred in concession contracts. More Costa Ricans should be notified about the existence of this arbitration center, and their right to use this resource to settle real property disputes in an efficient manner.

Costa Rica has a Real Estate Brokers' Chamber of Commerce that is affiliated with the real property arbitration center. The chamber is very proactive on training brokers and suggesting institutional and legal reforms. They are worried about the flow of illegal immigrants who practice the profession of real estate brokers without knowledge of the local laws and regulations. Virtually anyone can be a real estate broker because there is no licensing requirement. In addition, there is no training or certification requirement for practicing as a real estate broker. Accordingly, ignorant and unprepared real estate brokers are damaging the reputation of honest brokers and the country by committing fraud.

Some private companies offer property title investigations, legal support, and financial information. However, information supplied by these private service providers is often outdated. The National Registry sold property data to those companies in the past, but it has stopped doing so until those service providers are subject to professional or government regulation. At least one case arose from fraudulent information purchased from these private service providers.

Title guaranty services are available through Stewart Title Guaranty Company. It undertakes escrow and title guaranty services devoted to protecting the potential buyer when acquiring land and indemnifies for losses, if they arise.

E. SOCIAL DYNAMICS

The main problem in real property has to do with the dichotomies between the Real Property Registry information and the Cadastre Registry. The National Registry is aware of these inconsistencies, and is implementing reforms. The Inter-American Development Bank project is a positive step toward reform, but the benefits of that project will not be seen in the short term.

The National Registry is willing to undertake managerial and technological reforms. It does not receive funds from the central government; rather, it is a self-supporting entity. The National Registry has revenues exceeding \$1.7 million, as noted by officials, which it cannot spend as a result of central government restrictions on the expenditure levels. The funds are deposited in a non-interest accruing account. Requests have been made to the central government to increase the expenditure limit so that the National Registry could spend more of its own funds to promptly increase the quality of its services.

There is a constant demand for the imposition of higher standards on notaries and a growing concern about fraudulent practitioners within the profession. Also, relatively high notary costs have a chilling effect on formal registration of land transactions. New specialization requirements are mandatory as of recent date, but they are not considered sufficient.

The growth of nonprofessional real estate brokers who collude with some nonprincipled notaries is a significant cause of fraud. The National Assembly has been considering a bill to regulate real estate brokers, but the bill is not considered a top priority.

F. RECOMMENDATIONS

- ♦ Private and public consensus should be built around real property. Key issues are as follows:
 - (a) In regard to expropriation compensation, mechanisms should be developed to guarantee that compensation is fully and promptly paid.
 - (b) The expenditure level of the National Registry should be increased, which would guarantee that the Registry's funds are invested in a short-term modernization of the Registry and would provide transparency to the process.
 - (c) The professional standards of notaries and real estate brokers should be improved. The involvement of all stakeholders in this process could be the engine that pushes for automated control mechanisms to protect against fraud.
 - (d) Squatters' rights should be handled in a manner that incorporates them into the legal system and respects the rights of existing owners. Recognition of rights on some governmental land could be recognized.
- ♦ Property expropriated should be paid fully and promptly at market value. An assessment of the status of expropriation payment should be conducted. Priorities should be established for payment depending on the length of time payment has been pending, geographic area, and country's economic interest.
- ♦ Legal reforms are necessary to increase the standards of notaries and real estate brokers. Once a consensus is built, a major assessment of the scope of such reforms necessary, and an analysis of the economic impact of such reforms, are essential.
- ♦ Zoning is being implemented in a disorganized manner by many entities. An assessment must be conducted outlining existing zoning regulations, and reforms necessary. A subsequent institutional reform or strengthening might be necessary. Strategic planning techniques should be introduced through training to public officers as part of those reforms.
- ♦ Real Property is subject to an annual tax and a transfer tax. In some cases, a shell corporation owns the property, so the property transfer is accomplished by transferring the corporation's shares to avoid payment of property transfer tax. Likewise, the property value is underestimated for the same reason: pay less annual real property tax. In general, Costa Rica requires a tax assessment that determines what changes need to be undertaken

to subsequently implement a tax system reform that is much friendlier to business. Real property taxes should be part of that project.

VI. COLLATERAL

A. INTRODUCTION

Costa Rica's law of secured transactions is inadequate for meeting national and regional commercial credit needs. Although foreign investments in Costa Rican industry and commerce have increased significantly during the last three decades, these investments, as a rule, are financed from non-Costa Rican sources, usually at affordable rates of interest. In contrast, small and medium-sized Costa Rican businesses have to pay an interest rate of 25 percent to 30 percent per annum in their bank borrowings, according to interviews. If they were to borrow from nonbanks, these loans would usually command an even higher rate of interest.

The scarcity of commercial credit and its resulting high cost lead Costa Rican small and medium-sized businesses to finance themselves out of limited savings, thus hindering the economic development that reasonable rates of interest would have made possible. Therefore, unless Costa Rican small and medium-sized businesses can borrow at reasonable rates, such as is available to (among others) United States investors and exporters, Costa Rica will experience the same significant loss of small and medium-sized businesses suffered by Mexico after joining the North American Free Trade Agreement (NAFTA).

On the other hand, if Costa Rica were to modernize its secured lending law and unify it with that of its Central American neighbors, it would be able to act as an effective engine for its own development and for regional economic growth. Costa Rica's history of political stability, democratic institutions, and relatively low level of judicial corruption continue to attract foreign investment in significant numbers. Its financial sector seems poised to interact with its counterparts in the other Central American republics and in North America as a lender, borrower, merchant banker, syndicator, and underwriter. Hence, with the help of legal modernization and harmonization with its regional counterparts, the Costa Rican financial institutions would qualify for assistance and cooperation by some of the largest secured lending institutions in the United States and Europe. These institutions have made it clear that they would be prepared to "open the credit valve to Costa Rica at reasonable rates of interest, provided it and its sister republics in Central America jointly upgrade and harmonize their secured lending and registry law in a manner consistent with the OAS Model Law."⁶

B. LEGAL FRAMEWORK

An effective system of secured lending is the product of (a) an up-to-date substantive law; (b) a fully transparent, accurate, and easily accessible registry of debtors and of individually valuable collateral that can be identified by serial number or other means of individual identification; (c) an enforcement of security interests by means of extra-judicial self-help and by the speediest of judicial processes of execution of the various security interests; and (d) a sound central banking or regulatory policy that carefully monitors the lending risks and rewards prudent lenders with

⁶ Conversation with Richard C. Palmieri of the Commercial Finance Association, during the 35th session of the United Nations Commission on International Trade Law (UNCITRAL), New York (June 17–28, 2002).

access to liquidity and better rates of interest.⁷ In mature legal systems (i.e., systems that rely on ordered and hierarchical sources of law and that articulate the functions of their key legal institutions), elements (b), (c), and (d) above are the result of the proper implementation of element (a).⁸

Costa Rica's law on security interests on personal property collateral is found in its Commercial and Civil Codes (*Código de Comercio* and *Código Civil*).⁹ Its procedural law and its registry law on secured lending are scattered among multiple sources—ranging from civil procedural codes to administrative and agrarian law—which apply, often confusingly, depending on the type of pledge and jurisdiction involved. This confusion will become apparent in the discussion of Costa Rica's decisions on pledges.

In addition, its substantive law only allows “owners” (*propietarios*) of the movable property to become secured debtors and file security interests in their collateral.¹⁰ If this requirement were to be taken seriously by Costa Rican registrars and judges, it would prevent the creation of most contemporary security interests in personal property because most secured debtors in the current financial marketplace are not owners of the collateral relied on for asset-based lending. Contrary to the status of mortgagors of real property, possessors of personal property can seldom prove their “historical” (or chain of title) ownership of the collateral.

Ever since the adoption of the French Civil Code (Article 2279) principle of “possession is the equivalent of title” (*possession vaut titre*) and the coetaneous introduction of negotiable documents of title, ownership of movable property was divided or, more accurately, “fragmented” into multiple possessory rights. Consequently, multiple debtors and creditors could claim their right to the possession of the same collateral at the same time or different times. Among such claimants are unpaid sellers of goods who retain their right to recover the goods sold to defaulting buyers, buyers of goods pursuant to a sale agreement, creditors who hold “title” to negotiable ocean bills of lading or warehouse receipts as holders or endorsees, carriers or warehousemen whom statutory law grants a lien or right of retention of the goods they carry or store for unpaid freight or storage, “direct” or “financial” lessors of equipment, trustees of guaranty trusts, and bona fide purchasers in the “open market” of the goods bought on credit by some of the above secured debtors. Clearly, the right of these participants in the credit marketplace to possess the collateral in question falls short of the “proprietary” right required by Costa Rican law.

⁷ Introduction to National Law Center for Inter-American Free Trade, 8 *Financial Scenarios of Secured Lending in the NAFTA countries*, (NLCIFT, 1999); see also Boris Kozolchik and John Wilson, *The OAS Model Law of Secured Financing*, Uniform Law Review.

⁸ See Boris Kozolchik, *Introduction to Distinguished Perspectives on the Law Lecture Series at Charles III, University* (Madrid Spain, December 2003).

⁹ For example, the “traditional” or possessory pledge (*Prenda con Tenencia*) article 441 of the Civil Code; the “pledge of a credit” (*Prenda de un Crédito*), article 442 of the Commercial Code; the “commercial pledge” (*Prenda Comercial*), articles 530 and 533 of the Commercial Code; pledge with dispossession (*Prenda sin Tenencia*) article 537 of the Commercial Code.

¹⁰ Commercial Code, article 238. “The inscription in this Registry shall be discretionary and shall be performed when so required by the owner (*Artículo 238.-La inscripción en este Registro será facultativa y se practicará cuando el propietario así lo solicite*)” (*Emphasis added*).

In light of this and other substantive law shortcomings, it is not surprising that more than one interviewee concluded that the financing of small and medium-sized businesses in Costa Rica was an uncommon and risky endeavor. Some of the interviewees noted that in recent years a “guaranty trust” (*fideicomiso de garantía*) has begun to be used to avoid some of the substantive law uncertainties of the repossession or foreclosure of the collateral. Yet, this legal device still lacks a legislative basis. In the absence of such support, repossession or foreclosure pursuant to such a deed of trust may well be deemed a violation of the Costa Rican prohibition of the *pactum commissorium*.¹¹

Some interviewees, and some of the responses to USAID’s CLIR indicators, believed that Costa Rica’s substantive law allowed perfection of a security interest in a borrower’s constantly revolving business inventory. Yet when these interviewees were questioned further about either a debtor’s ability to freely re-sell or re-pledge this inventory, or a secured creditor’s right to trace his/her rights in the inventory into first-, second-, or third-generation proceeds, the response invariably was negative. One interviewee who expressed familiarity with such a security interest admitted to failure when attempting to police such a loan. He also admitted to failure when attempting to foreclose in a timely manner. Not surprisingly, a banking supervisor pointed out that inventory lending is classified among the riskiest of loans in Costa Rica pursuant to the International Bank for Reconstruction and Development-Basle listing of risks in relation to the adequacy of bank capital. A high official in the Costa Rican National Registry similarly acknowledged that neither Costa Rica’s substantive law, nor its registry law, was designed to accommodate these “modern,” rapid, and voluminous commercial loans.

In summary, although Article 533 of the Costa Rican Commercial Code states that a pledge may include any type of movable property, its listing of the collateral that can be pledged involves mostly tangible goods and goods susceptible to registration by detailed individual description and serial number. Negotiable instruments and investment securities are as close as Costa Rican law gets to allowing intangible goods (e.g., accounts receivable) as collateral. Left unprotected are, among others, accounts receivable and proceeds financing; trust receipt financing; fixtures financing or security interests in fixtures separate from those in the real property to which the fixtures are attached; and purchase money security interests or super priorities under ordinary and bankruptcy conditions.

Not surprisingly, and as a result of market pressures, attempts to amend existing code law piecemeal are beginning to emerge. Institutional lenders are advertising credit extensions on the

¹¹ The *pactum commissorium* allows a secured creditor to appropriate to his/her own use or to resell the collateral pledged by the debtor if the latter defaults. This pact was outlawed during Constantine’s reign in 326 A.D. Significantly, the main policy reason given for Constantine’s prohibition of the *pactum* was that it enabled lenders to evade the severe penalties imposed by Christianized Roman law upon usury. Usury was defined in Constantine’s time as any interest charged above and beyond the return of the principal amount. By encumbering property worth considerably more than the value of the loan, a secured creditor who recovered such property invoking the *pactum* could wind up collecting his principal and interest in a usurious loan. Despite the fact that the prohibition against usury was considerably attenuated in Latin America’s 19th and 20th century civil and commercial codes, the prohibition of the *pactum* has continued unabated to this day. It has retarded the modernization of not only secured transactions, but also of commercial and remedial law. See Constantine Const. of 324 and Justinian 3rd Const. Cod. 7, 54. On the interaction between usury and the invalidation of the *pactum commissorium* see, Boris Kozolchyk, *Law and the Credit Structure in Latin America*, 7 VA. J. INT’L L., 10, 11 (1967).

basis of “financial leasing”—ignoring the inadequacies of their protection under existing law. Indeed, the longer this piecemeal modernization of secured lending law continues, the more difficult it will be to achieve a unified system of regulation for all the security interests nationally and regionally.

Overall, Costa Rica’s substantive and procedural laws on secured lending are inadequate for meeting national and regional commercial credit needs—particularly those of micro and small businesses planning to expand and/or improve their commercial activities with a view to taking advantage of CAFTA benefits. This situation has not been improved by Costa Rican case law, making the quick and inexpensive realization of the security interest an unattained goal in Costa Rica.

C. IMPLEMENTING INSTITUTIONS

1. National Registry of Movable Property

This National Registry comprises six individual registries devoted to (a) real property; (b) cadastral or physical mapping of real property; (c) vehicles and movable property; (d) intellectual property, including industrial property; (e) copyright and related rights; and (f) business associations. Regional branches of the National Registry exist in Liberia, Guanacaste, Punta Arenas, Limón, San Carlos, Pérez Zeledón, Alajuela, and the Western Sector (*Sector Oeste*) of San José. Each registry has its own director and personnel. Registries support themselves by collecting registry fees. Private databases on the debtors’ credit history are also available for a fee. These databases collect information about debtors’ default, insolvency, and adverse lawsuits. Although the National Registry sold its data to private databases, it has suspended sales such as these until the Congress enacts a law determining the lawful uses of this information.

As noted earlier, filings in this registry are reserved for movable non-fungible property identifiable by serial number and only for such property.¹² For example, as pointed out in the Costa Rican Experts’ Report, Article 236 of the Commercial Code established the national and only Registry of Movable Goods (*Registro de Muebles*) in San José.¹³

According to in-country interviews with notaries and lawyers it was noted that although the National Registry is self-supporting and has accumulated a significant unused surplus, it has not contributed to the lowering of transactional costs. Filing fees for real and personal property transactions are based on a rate of one per thousand of the declared value of the transaction. If the transaction involves a sale, then the rate jumps to five per thousand of declared value. To these fees, creditors and debtors must add significant notarial fees (as will be discussed shortly) and transfer taxes where appropriate. These costs reflect a vision of social wealth premised on

¹² Commercial Code article 237: “All non-fungible movable goods that can be identified either by their number, series or brand or other characteristics that describe them, shall be registered in this Registry” (*Se inscribirán en este Registro todos aquellos muebles no fungibles que puedan identificarse ya sea por su número, serie o marca u otras características que lo describan*).

¹³ Commercial Code article 236: “Create the Registry of Movables with headquarters in the city of San José, that shall act jointly with the Registry of Pledges.” (*Créase el Registro de Muebles con asiento en la ciudad de San José, que actuará conjuntamente con el Registro de Prendas*).

the notion that real property transactions are the most revenue producing for the parties and for governmental and private sector institutions.

Thus, the filing procedure for movables faithfully echoes that which is used for real property mortgages in the Real Property Registry. The deed containing the credit extension contract and the pledge are the documents presented for filing. These multipaged, complex legal documents contrast sharply with the single-paged, simple financing statements filed in paper or electronically with Canadian and United States registries. The most common secured transactions with personal property in Costa Rica involve the pledge of motor vehicles or agricultural goods. These transactions must be executed before a notary. Notary fees are roughly 1.25 percent of the amount involved, as noted by interviewed notaries and lawyers..

Security interests in other types of collateral of less value may be filed as private (non-notarial) deeds. Upon receipt of the notarial deed by a registrar in the San José offices of the National Registry, the filing is stamped, dated, and provisionally filed in a daily ledger for purposes of temporary, albeit revocable, perfection, and priority. According to Registry officials, the registrar examines the document filed and is required to respond within eight days from the date of the filing, either approving it and filing it permanently, or rejecting it and indicating the mistakes to the filer or to the executing notary. Mistakes are commonly detected and may result from missed formalities, including absence of or mistyping of standard clauses or from inconsistencies with previous filings. Occasionally, the notary corrects the mistakes or inconsistencies within a day or two from the time he or she received the document from the registrar. More often, the correction, refiling, and recorection can take months from the time of original filing, including the time for administrative and judicial appeals from the decision of the registrar. Once the examination or appeal process concludes, the filing is permanent and the security interest is perfected and will acquire priority.

Note that since enactment of the notarial law in 1998, notaries have been responsible for the filing of security interests in the National Registry. Note that in contrast with the method of preserving filed real property mortgage documents through optical scanning, the preservation of pledge records is by means of more a dilatory and difficult-to-locate microfiche system.

The limited scope of the National Registry as provider of notice for security interests in personal property collateral is apparent from its daily volume. Despite the fact that all the security interests in Costa Rica that affect third parties must be filed in the National Registry, its daily volume of filings does not exceed 1,000. Interviewed notaries and Registry personnel stated that this is a very low number for a population that exceeds 4,000,000—many of whom, albeit non-merchants, engage in secured transactions especially involving vehicles. The highly formalistic and cumbersome procedures result in delayed notice to creditors and bona fide purchasers. A source familiar with the registration process estimates that as many as 50 percent of the deeds filed are returned to notaries for corrections or redrafting.

On the other hand, this source acknowledged several instances of registrars' misfeasance and corruption. During the last year alone, 27 registrars were fired for venal conduct. When asked about malpractice insurance, the response was not as clear. Apparently, there is a comprehensive policy purchased from INS, the Costa Rican state insurance company. This purchase was

mandated by a 1998 law, but the exact coverage of this policy, despite the repeated instances of registry malpractice, has yet to be clarified.

Several knowledgeable parties suggested a movement toward a highly automated, non-evaluative type of filing in a Central American Commercial Registry organized by debtors' names. Such a registry would absorb most of the information in the present registry of business associations and combine it with information on collateral identified by serial number. The data of such a registry would be made available to actual or potential lenders or bona fide purchasers of the collateral anywhere using computer-to-computer communications. The Costa Rican National Registry has pledged its support for such a process.

In summary, the National Registry is not equipped to handle the filing of contemporary secured transactions expeditiously, economically, and reliably. Costa Rican laws do not contemplate the existence of a centralized registry for collateral or a debtor registry. A modern system for secured lending requires this type of debtor indexing, which allows interested parties to search the registry to determine the existence of liens on a particular debtor's property by using the debtor's name. Several important features of a secured financing system cannot function properly if the registry index is based on real property rules requiring collateral descriptions instead of debtor names. Security interests such as in future goods, inventory, and accounts function only with a system that allows for general collateral descriptions, not for the detailed identification of goods. Consequently, a modern registry system cannot function based on a collateral criterion; rather, it can function only when debtor names are used as the registration-search criterion.¹⁴

Finally, Costa Rica's substantive and registry laws are not designed to accommodate modern, speedy, and voluminous commercial loans that are common and necessary for growing economies and increased foreign investment. A modern electronic registry should accommodate presentation not only in person but also by various forms of electronic transmittal (e.g., mail, fax, modem, courier, and electronic data interchange [EDI]). Ideally, registry reforms (and, overall, legal reforms to accommodate an electronic system) should be based on the guidelines established by the UNCITRAL Model Law on Electronic Commerce, UNCITRAL Model Law on Electronic Signatures, and Uniform Inter-American Rules on Electronic Documents and Signatures (IAREDS), which enable presentation by "any other method which is accessible for later consultation and which can be produced in a tangible form recognized by law or custom." Furthermore, registry modernization should eventually lead to an integrated network of Central American registries.

2. Courts

Given the inadequacies of the substantive and procedural law of pledges, it is not surprising that Costa Rican courts have been unable to clarify basic questions of applicable law and have added to the existing uncertainty. For example, in a decision by the First Chamber of the Supreme Court of 1992, the court stated that if the pledge involves an agrarian enterprise, only agrarian courts are competent to decide on the pledges involved.¹⁵ This decision (and those that the

¹⁴ See further, Kozolchik and Wilson, *The OAS Model Law of Secured Financing*, *supra* note 7, at 48-49.

¹⁵ See Resolución 002-C-92.AGR, (Sala Primera de la Corte Suprema de Justicia, Jan. 8, 1992), in NLCIFT database and NLCIFT Preliminary Study on Costa Rican Decisional Law Involving Pledges, NLCIFT, 2004, at p.1. (the "NLCIFT Preliminary Study").

Supreme Court lists as supporting it) leads to possibly concurrent and not always converging rules for agrarian and nonagrarian pledges in collateral. Such conflicting rules would apply to pledges that at one point were agrarian and subsequently entered the stream of nonagrarian commerce. Accordingly, a security interest in, say, the production of milk that eventually found itself being bottled for wholesale and retail distribution, would be subject to different and possibly contrary judge-made perfection and priority rules once it became the inventory of the wholesale or retail distributor of milk. Thus, a lender to the latter would not know whether he or she was governed by the law created by the agrarian court or by the case law of ordinary civil or commercial courts.

The multiplicity of substantive and procedural law sources has allowed litigants to repeatedly raise issues of improper jurisdiction and venue. The Supreme Court of Costa Rica in various decisions referred to the inconsistency between Article 678 of the Procedural Civil Code and other procedural law provisions found elsewhere. Article 678 provides that the venue of the competent tribunal is that of the domicile of the debtor, the place where the property is found or the domicile of the creditor. However, the court did not clarify whether the above venue provisions should be interpreted sequentially or interchangeably.¹⁶ Many appeals reviewed resulted from the aforementioned uncertainties.

When combined with the tendency of the Costa Rican Supreme Court in the early 1990s to rely on excessive procedural formalism, the result from the standpoint of the certainty of the law of pledges was disquieting. Consider, for example, a 1991 decision by the Second Chamber of the Supreme Court¹⁷ involving the requirement of authentication of the signature of the secured debtor by a notary. This decision rejected the filing of an otherwise complying pledge certificate because it contained only an authentication by a lawyer who did not state that he or she was a notary public, even though lawyers can become notaries in Costa Rica by complying with few perfunctory formalities. *Mutatis mutandis*, the same court sanctioned the rule that foreclosure of a pledge regardless of how perishable the collateral or rapidly declining in value, was suspended until the conclusion of an administrative appeal (*ocurso*) against its filing. In its decision, 784 of July 23, 2003, the Supreme Court stated that even though the secured debtor had waived objections to the foreclosure procedure (*ejecutivo prendario con renuncia de trámites*), the filing of an *ocurso* was an exception to such a waiver. Consequently, the foreclosure was suspended until the final determination of such an appeal.

Costa Rica's judicial system is unreliable and unprepared to deal with modern secured transactions concepts. Costa Rican case law has not helped mitigate the inadequacies of Costa Rica's substantive and procedural laws on secured lending. The modernization of Costa Rica's secured transactions laws and the enactment of rules governing a collateral registry should go hand-in-hand with the training of judges, modernization of the court system, and implementation of new procedures to collect debt and seize and sell collateral efficiently and expeditiously. Absent the modernization of secured transactions laws, the creation of a collateral registry, and

¹⁶ See No. 61 (Sala Primera de la Corte Suprema de Justicia, Apr. 21, 1995) in NLCIFT database and NLCIFT Preliminary Study, at p.2.

¹⁷ See Resolución 91-116, (Sala Segunda de la Corte Suprema de Justicia, Dec. 20, 1991), in NLCIFT Database and NLCIFT Preliminary Study, at p.3.

the implementation of expedited procedures, lenders will continue to charge high-interest rates to cover high risks in their loans.

D. SUPPORTING INSTITUTIONS

Increasingly, business and industrial associations, as well as NGOs, are becoming aware of the importance of providing commercial credit at reasonable rates of interest to Costa Rican and Central American small and medium-sized businesses. Representatives of Costa Rican Chamber of Industries, banks, and economic development NGOs acknowledged the seriousness and urgency of the problem and the need for a modernized regional law as a result of the small size of the individual country markets. In addition, they all pledged their participation in the process of adopting the OAS Model Law on secured transactions for Central America. Similar expressions of support were expressed by leading members of Costa Rica's commercial bar, Justices of the Supreme Court, and high officials of its foreign trade ministry.

E. SOCIAL DYNAMICS

Despite the inadequacies of Costa Rica's substantive and procedural law and of its case law, the future of secured lending in Costa Rica is very promising as a result of the emergence of customary law institutions such as expedited extra-judicial foreclosure procedures for commercial bank pledges (foreclosures through "sworn" brokers or *corredores jurados* rather than by courts). In addition, there is widespread realization among key members of the public and private sectors that secured lending law must be modernized as soon as possible in Costa Rica and Central America. Key regulatory policies, such as that by the Superintendence of Banks to require a 10-percent capital adequacy ratio in relation to assets (mostly loans), can lead only to a greater emphasis on high-quality (liquid) collateral—meaning collateral endowed with effective and up-to-date notice to other secured creditors and bona fide purchasers by means of an electronic Commercial Registry and susceptible to being converted into cash quickly and inexpensively.

F. RECOMMENDATIONS

- ♦ The inadequacies of Costa Rican substantive or procedural laws have not been remedied by Costa Rican registry and case law. Consequently, a quick and inexpensive realization of Costa Rican security interests remains an unattained goal until a program of substantive, procedural, and registry law modernization is undertaken not only in Costa Rica but also regionally.
- ♦ Despite the inadequacies of Costa Rica's substantive and procedural law and of its case law, the future of secured lending in Costa Rica is quite promising as a result of the emergence of customary law institutions such as that of expedited extra-judicial foreclosure procedures for commercial bank pledges (foreclosures through "sworn" brokers or *corredores jurados* rather than by courts). In addition, there is widespread realization among key members of the public and private sectors that secured lending law must be modernized in Costa Rica and Central America in the nearest possible future. Key regulatory policies, such as that by the Superintendence of Banks to require a 10-percent capital adequacy ratio in relation to assets (mostly loans), can lead only to a

greater emphasis on high quality (liquid) collateral—meaning collateral endowed with effective and up-to-date notice to other secured creditors and bona fide purchasers by means of an electronic Commercial Registry and susceptible to being converted into cash quickly and inexpensively.

- ♦ Because Costa Rica has one of the most modern registry systems in Central America and in the Americas and one of the most respected judiciaries in the same region, donors should work with Central American public and private sector representatives to create a Central American permanent entity—to be located in one of the Central American nations—whose function will be to implement the adoption of the OAS Model Law on Secured Transactions in the region, including a regional electronic Commercial Registry, and to research the best method for developing and enacting modernized and unified commercial laws for the region.
- ♦ Training should be provided to judicial and administrative officials to facilitate implementation of modernized laws and systems. Modernization of Costa Rica's secured transactions laws and the enactment of rules governing a collateral registry need to go hand-in-hand with the training of judges, the modernization of the court system and the implementation of new and expedited procedures to collect debt and seize and sell collateral in an efficient manner.

VII. COMMERCIAL DISPUTE RESOLUTION

A. INTRODUCTION

Facilitation of foreign investment and trade, as well as local commerce, requires that those involved have confidence that disputes can be settled fairly and efficiently, without exorbitant expense. Measured against this standard, the situation in Costa Rica is neither very good, nor very bad. On the one hand, the level of corruption in the courts seems to be less than in other countries in the area. On the other hand, court delays are very long. A complete view of the possibilities for commercial dispute resolution, however, includes the availability of ADR mechanisms such as arbitration and mediation, which are more advanced in Costa Rica than in other countries in the area.

B. LEGAL FRAMEWORK

Costa Rica's Constitution establishes a system of separation of powers, within which the Costa Rican Supreme Court appears to be a strong and respected institution. Nevertheless, long delays in the judicial process and lower level corruption have undermined the capacity of the Judicial Branch to function effectively.

Costa Rica has a civil law legal system derived from Roman law—specifically, from Spanish Law, as influenced by French Codification. In Central and South America, the legal order is often marked by rigidly formal rules that are inapplicable to reality—that is, often the law in practice does not correspond to the formal law. In this respect, Costa Rica appears to be in better shape than its neighbors. Nevertheless, to the extent that courts are not functioning well, it can be expected that the formal law will be less effective in governing actual practices.

The Costa Rican court system has a hierarchy of courts. Cases proceed from courts of the first instance, *casación*, based on judicial districts; then to appellate courts depending on subject matter and amount in controversy; and finally to the Supreme Court. The administrative rules for the judicial branch are set forth in the *Ley Orgánica del Poder Judicial*.

Jurisdiction and venue are set by statute. The Supreme Court's jurisdiction is mandatory, provided the appealing party satisfies the statutory requirements. Moreover, the constitutional chamber of the Supreme Court has original jurisdiction, allowing the plaintiff to file constitutional challenges directly in that chamber of the Supreme Court. As a result, according to interviewees knowledgeable of the situation, the Constitutional Chamber has 12,000 pending cases.

The law provides special jurisdiction for bankruptcy courts, tax courts, and the like. The law also provides for administrative courts or agencies and for review in the court system. For example, the Tribunal Registral and Tribunal Fiscal Aduanero [*Jurisdicción Contencioso-Administrativa*], review the National Registry's acts.

ADR is recognized and governed by the Law on Alternative Dispute Resolution of Conflicts and Promotion of Social Peace, No7727. Costa Rica is a signatory of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

Other than the Constitution, it does not appear that even major laws in Costa Rica are available in English. On the one hand, outsiders will necessarily need to engage Costa Rican attorneys and other intermediaries. On the other hand, foreign investors will want their own attorneys to be able to read the laws and regulations that would be applicable to determine whether they wish to pursue trade or investment in Costa Rica.

C. IMPLEMENTING INSTITUTIONS

The Judicial Branch (*Poder Judicial*) of the Costa Rican government is headed by the Supreme Court. That branch also includes appellate courts and trial courts. The Supreme Court consists of 22 judges, with a pool of additional persons who can fill in on an ad hoc basis. The Court is divided into four chambers. The first three have five judges, and the fourth has seven. **Chamber I** has jurisdiction over all civil and administrative matters. **Chamber II** has appellate jurisdiction over civil matters, including family law, estates, and labor law. **Chamber III** hears only criminal appeals. **Chamber IV**, added in 1989, has exclusive jurisdiction over all constitutional matters.

The Costa Rican judiciary is distinctive in at least two respects. First, it includes the Judicial Police and the Public Minister (i.e., the Prosecutor). The Judicial Police, which is separate from the regular police, assists the Prosecutor. The inclusion of the prosecutorial functions within the judiciary conflicts with traditional understandings of separation of powers that consider the prosecutor's function to be part of the executive power.

Second, the Judicial Branch is distinctive in that it is guaranteed at least six percent of the total budget. That figure covers not only the entire Judicial Branch, which includes the courts, but also the Judicial Police, Public Minister, and Public Defender. Although this guaranteed funding would seem to offer a degree of independence to the judiciary, the amount may be inadequate as a result of the inclusion of the other agencies. Judges' salaries are said to be adequate; reportedly, lower level employees are inadequately paid, which may contribute in part to corruption at the lower levels of the Judicial Branch.

There is a set of administrative tribunals within the Executive Branch that is poorly funded. Parties must exhaust their administrative remedies before appealing to a court. In consumer matters, however, the plaintiff has a choice of filing initially in the court. Unlike the courts, the administrative tribunals do not impose attorneys' fees on the losing party.

All parties cite delay as the major problem with the court system. There are about two million cases pending, with 1 million per year being filed. According to interviewees, ordinary cases can take six to ten years to resolve. The courts lack sufficient, well-paid personnel to handle the caseload.

The process of enforcement of judgment is also slow. Carried out under the Code of Civil Procedure, the process can take two years. It seems that the quality of enforcement has declined in recent years, and is less efficient than before.

Although additional resources would be helpful, delays could be alleviated in the Supreme Court by granting the Supreme Court discretion in hearing cases rather than its current mandatory jurisdiction. Indeed, it appears that the Supreme Court has, out of necessity, developed methods

to give only a cursory review to certain cases. With discretionary review, however, most cases would be refused relatively quickly without explanation.

A large part of the delay occurs right at the beginning with service of process that can take two years. In San José, street numbers are often not used, though they exist, presenting a problem when seeking an address for service of process. Rather, addresses are given in terms of landmarks and distances therefrom. Moreover, service of process outside the district in which the trial court sits is problematic at best. The police of another district are said to be uninterested in serving papers from the court of a different district. To ensure that the police perform what they consider additional work, lawyers apparently “network” with them. The situation suggests that part of networking by the lawyers includes a payment to police to bring about service of process. A statute allowing for service by private companies could eliminate such delay and corruption.

As in many court systems, the behavior of lawyers causes certain delays. Costa Rica has excessive litigation, which is attributed in part to the large number of lawyers relative to the population. Lawyers acknowledge the common problem that some lawyers draw out a case for as long as possible. Those Costa Rican lawyers who bill by the hour, like lawyers elsewhere, have a disincentive to favor an efficient court system.

Given the lack of legislative reform to assist the courts, the use of ADR offers a partial solution to the situation of delays. Although provided for in law, ADR is underutilized. The courts themselves require the parties to participate in a process of conciliation conducted by a judge. The courts do not, however, encourage private ADR. The conventional wisdom within the judiciary is that, despite delays, people prefer the courts to resolve disputes.

Among lawyers, attitudes about ADR vary. Some make considerable use of it, whereas others resist the practice. Nevertheless, ADR is increasingly used to settle disputes. As corporate clients realize savings in time and expense, they, their attorneys, and business associations promote the use of ADR.

Arbitral awards are routinely upheld in the courts. A rare example of a court’s refusal to enforce an award based on its failure to include all the elements of a court judgment illustrates the problem of competence among some judges. Judges are civil servants who generally have not practiced law. Although their salaries may be good by civil service standards, they are low as compared with practicing lawyers. Given the formalism of their education and the lack of practice, some of the judges may not have adequate background for the needs of a commercially developing society.

D. SUPPORTING INSTITUTIONS

Many law schools operate in Costa Rica, including some which were described during assessment interviews with legal professionals as “diploma mills.” Eighty recognized colleges and universities exist and most of them have law schools. The number of lawyers has been growing rapidly. For example, according to information gathered during the assessment, in the last 15 years the number of lawyers in this nation of 4 million people has risen from 5,000 to somewhere between 14,000 and 18,000. That is a large number per capita, even by North American standards. Many lawyers, however, either do not practice law or they serve in

government. As a result, according to interviewees, a better gauge of the number of lawyers in private practice may be the number of notaries, which currently number upwards of 9,000 individuals. Unlike some other Latin American countries, the legal and notarial professions are not separated. In Costa Rica, most attorneys in private practice are also notaries.

Lawyers are not required to pass a bar examination. Graduation from a law school in Costa Rica, which itself is not held to any standards, is sufficient. Thus, virtually no quality control exists for lawyers. Even for those lawyers who have received a solid basic legal education, there are insufficient resources for continuing legal education necessary to support legal reforms.

The state insurance monopoly presents another major problem resulting in delay. As a monopoly, it provides insurance for the plaintiffs and the defendants in automobile accident cases. Apparently, the state's insurance company insists that all cases be appealed. The systemic inefficiencies caused by this monopoly serve solely to drive up administrative costs. The state should assess the viability of using negotiation and other forms of ADR. Such a change would have the added benefit of alleviating congestion in the courts.

Some business and other associations have been promoting ADR in recent years. The Costa Rican Chamber of Commerce and the American Chamber have centers for dispute resolution. Professional associations operate specialized centers for real estate, architecture, construction, and labor. Whether by accident or purpose, this specialization reflects a more developed approach to arbitration. Such profession-specific ADR is encouraging, even though the number of cases currently handled is insignificant. Increased use of ADR requires greater promotion about the process and its availability. Furthermore, the law that limits arbitrators to Costa Rican lawyers presents barriers for the use of ADR in cross-border transactions.

The business community is a positive factor in promoting ADR. The proliferation of law schools and the resulting dilution of quality among some portion of the attorneys is a negative factor.

E. SOCIAL DYNAMICS

The Legislative Assembly has not been responsive to the Court's attempts to enact reforms.

Some reforms have come at the insistence of outside donating agencies, notably the International Monetary Fund (IMF) and the World Bank. Notably, USAID was influential in the passage of the ADR law.

The prospects for reform are affected by the dynamics of a political clash between the Supreme Court and Legislative Assembly. The conflicts concern the budget and the issue of the eligibility of former presidents to seek the presidency. The Constitution requires budget approval by the Supreme Court, which is a continuing source of friction. The Constitution's prohibition of reelection of a person as President has also been a source of conflict. The Court has been asked twice to decide whether that prohibition applies only to immediate reelection. After initially deciding that the prohibition applied generally, the composition of the Court changed and a new decision from the Court reached the opposite result. Consequently, former presidents who have been out of that office are eligible to seek that office again. The political fallout from these

clashes has clearly affected the willingness of some in the Legislative Assembly to cooperate with the Supreme Court in reform efforts.

Commercial law reform and dispute resolution are inherently linked to anticorruption efforts. Although Costa Rica has a better reputation regarding corruption than its neighbors, the underlying problem for resolution of commercial disputes is a culture that seems to presume bad faith in commercial dealings. The system uses criminal fraud prosecutions in commercial contexts, such as those involving the pledge of collateral. Such prosecutions would be unnecessary if the commercial law were reformed in some of the ways suggested in the sections on improving secured transactions.

Corruption within the judicial system exists, but its extent is difficult to ascertain. Some citizens suggest that the delays in the system are the result of corruption. As the discussion of service of process suggests, some of the delay might be attributed to corruption or to inherent inefficiencies. The Supreme Court recognizes that corruption does exist at lower levels—for example, some clerks accept tips to expedite cases. Though allocation of cases to judges was once a source of corruption, the judiciary now uses a computer for random case assignments.

Anecdotal evidence suggests that corruption extends beyond the type characterized as “tips” to accomplish a job. A car theft victim described an experience that involved the ordinary police and the Judicial Police. After making an emergency report of the car theft, the victim received numerous calls from persons, said to be in jail, who offered to “sell” the car back to its owner. Later, after the victim had changed all his telephone numbers, he checked with the Judicial Police (which, as noted above, is part of the Judicial Branch) to determine whether the car had been located. He gave his wife’s new (as of the day before) cell phone number that had been given to nobody else. Shortly after his call, a call came to his wife’s cell phone number with yet another offer to sell back the car. Clearly, the later attempt and most probably the earlier attempts to scam the victim of the car theft could only have occurred with the cooperation of persons employed by state agencies. The number of calls suggested a widespread practice.

The judicial system in Costa Rica is broken, as reflected by its current, heavy caseload. It cannot handle the amount of litigation now, let alone the increase that will accompany increased trade under the Central America Free Trade Agreement (CAFTA). At present, the government is unable or unwilling to provide sufficient funds to cure the delays and corruption in the system. Therefore, the only viable option appears to be the increased use of ADR.

F. RECOMMENDATIONS

Although reform and increased funding for the judiciary is what is needed, such a broad-scale recommendation is not likely to be implemented. Under the circumstances, therefore, the following recommendations are more feasible:

- ♦ Priority should be given to educating businesses and attorneys about the advantages of ADR.
- ♦ Consideration should be given to amending the ADR law to allow non-Costa Rican attorneys to act as arbitrators, which would provide comfort to potential foreign investors.

- ♦ Funding should be made available for English translations of Costa Rican laws affecting trade and commerce to assist non-Costa Rican attorneys and businesses (especially small and medium-sized businesses and the attorney who advises them) who might consider exploring business opportunities in Costa Rica if they could more easily understand the legal environment.
- ♦ A bar association that establishes ethical standards, and the means to enforce them, for lawyers should be created. In addition, clear standards of education for lawyers should be created, such as the need to pass a bar exam, as well as the creation of a system of continuing legal education.
- ♦ The service of process, which currently can delay the start of legal proceedings up to two years, must be reformed and better regulated, particularly in those instances where service must occur outside the original trial district.

VIII. BANKRUPTCY

A. INTRODUCTION

Insolvency systems are an important element of financial stability. An effective insolvency system facilitates the rehabilitation of enterprises and provides an efficient mechanism for the liquidation of those enterprises that cannot be rehabilitated. Increasingly, the reform of the legal framework for insolvency has become an important component of international donors' economic programs in many countries because of the impact that such reform can have on the country's economic and financial system.

In the absence of adequate insolvency laws, individual creditors may compete to be the first to seize collateral or obtain a judgment against a failing debtor. It is in the collective interest of creditors that the reorganization or liquidation of a debtor be carried out in an orderly manner.¹⁸ In April 2001, the World Bank issued a report, "Principles and Guidelines for Effective Insolvency and Creditor Rights Systems."¹⁹ Even though the insolvency principles focus primarily on corporate insolvency, some of the concepts identified are also helpful when developing principles and rules for the insolvency of non-corporate and "mixed" capital debtors, (e.g., banks and decentralized entities).

The World Bank report suggests that a modern economy requires predictable, transparent, and affordable enforcement of secured and unsecured credit claims by efficient mechanisms within and outside the insolvency system. These systems must be designed to work in harmony.²⁰ The World Bank report provides that an effective insolvency system should (a) be integrated with the country's broader legal and commercial systems: insolvency reform is often ineffective without parallel reform of other commercial laws;²¹ (b) maximize the value of the company's assets by enabling it to reorganize; (c) strike a careful balance between liquidation and reorganization; (d) provide for equitable treatment of similarly situated creditors, including foreign and domestic creditors; (e) provide for timely, efficient, and impartial resolution of insolvency proceedings; (f) prevent the premature dismemberment of the debtor's assets by individual creditors; (g) provide a transparent procedure that contains incentives for gathering and dispensing information; (h) recognize existing creditor rights and respect the priority of claims with a predictable and established process; and (i) establish a framework for cross-border insolvencies, including the recognition of foreign proceedings and judgments and the cooperation and assistance among courts in various jurisdictions.²²

Costa Rica's legal framework for bankruptcy does not comply with these principles. Costa Rica's commercial laws do not provide a framework for efficient, transparent, and reliable methods for recovering debt, including seizure and sale of immovable and movable assets. As is the case with most Central American nations, Costa Rica's bankruptcy rules focus on the

¹⁸ See further, Group of 22: Report of the Working Group on International Financial Crises, October 1998, at 15 (the "G-22 Report"). Available at <http://www.imf.org/external/np/g22/ifcrep.pdf>.

¹⁹ The World Bank: Principles and Guidelines for Effective Insolvency and Creditor Rights Systems, April 2001 (the "World Bank Report"), available at <http://www.worldbank.org/gild>.

²⁰ *Id.*, at 3.

²¹ G-22 Report, *supra* note 18, at 15.

²² World Bank Report, *supra* note 19, at 4, and G-22 Report, *supra* note 18, at 16 and 44 (Annex A).

liquidation of business entities rather than on their reorganization. They do not provide for an equitable treatment of creditors, to the detriment of creditors located in a foreign jurisdiction. Moreover, Costa Rican law does not directly provide for the type of “rehabilitation” or “workout” procedures that are found in Chapter 11 of the United States Bankruptcy Code. Thus, Costa Rica is missing an important opportunity to enable some companies to return to viability and even profitability. This situation would likely be improved through strengthening of the existing legal framework, including better reconciliation of bankruptcy law with other commercial laws, and greater education of judges, lawyers, and other professionals about the theoretical and administrative aspects of a sound bankruptcy regime.

Overall, the virtual absence of a functioning bankruptcy system in Costa Rica represents a missed opportunity of potentially enormous economic significance—namely, a healthy market economy is one in which entrepreneurship and reasonable risk-taking is encouraged. Where creditors know that their investments are protected when an indebted enterprise falters or fails and that they will be able to seek and receive at least partial payment on the enterprise’s debt, they are more likely to loan money or provide goods on credit in the first place. The fundamental goal of commercial bankruptcy law is to allow for the fair and efficient dissolution of businesses that are not viable and, for those businesses that have a chance at achieving viability, the opportunity to extend, reduce, or wipe out debt and protect themselves from pursuit by creditors. This goal cannot be reached under present Costa Rican bankruptcy laws.

B. LEGAL FRAMEWORK

As is the case with some civil law countries, especially in Latin America, Costa Rican bankruptcy law is applicable only to merchants. Non-merchants are subject to separate rules not always consistent with those applicable to merchants.²³ Costa Rica regulates commercial bankruptcy mainly in articles 851–967 of the Commercial Code of 1964, and liquidation of financial institutions in Agreement SUGEF 24-00 containing the Regulation to Assess the Economic-Financial Situation of Controlled Entities²⁴ (*Acuerdo SUGEF 24-00, Reglamento Para Juzgar La Situación Económica-Financiera De Las Entidades Fiscalizadas* (hereafter “SUGEF 24”).

1. Commercial Entities

The declaration of bankruptcy can be requested by the debtor, or one or more of his creditors, provided the creditor can prove that one or more obligations are due and payable when (a) the debtor is hiding or absent without leaving a person responsible for his/her affairs, (b) the business is closed without justification, (c) the total assets of the merchant are assigned in favor of one creditor, or (d) evidence exists that the merchant is conducting his/her business fraudulently.

Creditors must prove their status by filing evidence of an unpaid and mature obligation, a negotiable instrument or public or notarial deed certifying to the unpaid indebtedness, and

²³ See arts. 884-982 of the Civil Code.

²⁴ *Acuerdo SUGEF 24-00, Reglamento Para Juzgar la Situación Económica-Financiera de las Entidades Fiscalizadas*. Updated February 2004, approved by the National Council of Supervision of the Financial System in its session 197–2000 and published in the Official Gazette number 6 of January 9, 2001.

evidence that the insolvent debtor is a merchant, even if the obligation is not commercial in nature. However, the law prohibits secured creditors from requesting the declaration of bankruptcy of the debtor unless he/she can prove that the debtor's assets are insufficient to assure the repayment of the debts owed.

Consistent with a principle found in other Latin American countries, Costa Rican law provides that declarations of bankruptcy made abroad will not apply to Costa Rica. This is a principle much criticized by entities such as the World Bank because of the uncertainty it engenders among foreign creditors and stockholders of the bankrupt. However, a declaration of bankruptcy of a company located abroad that has branch offices or agencies in Costa Rica will lead to liquidation of that company's assets in Costa Rica. In both cases, the assets located in Costa Rica are used to pay (a) the domestic creditors and (b) any foreign creditors.²⁵ This discrimination against foreign creditors has also been strongly criticized by international entities such as the World Bank. If, on the other hand, the branch or agency in Costa Rica of a foreign entity is declared bankrupt, the Costa Rican court will first order the payment of all creditors, national and foreign, domiciled or resident in Costa Rica. If any funds remain, the court will order the payment of non-domiciled foreign creditors who entered into contracts with the branch or agency. If funds remain after this payment, those funds will be remitted to the company's headquarters.²⁶

Creditors can propose settlement or "composition" agreements with the debtor. However, these agreements must be approved by those holding three-quarters of the total of the insolvent debtor's debts.²⁷ Secured lenders cannot vote in the meetings of creditors to decide on a proposed agreement with the debtor, unless they are willing to waive their security interests in favor of all the creditors.²⁸ Consistent with a highly judicial approach to insolvency, even of the most informal variety, the proposed "composition" agreements are subject to the approval of the judge.²⁹

Overall, Costa Rica does not have modern bankruptcy laws. The country's legal framework for bankruptcy does not comply with the principles outlined by the World Bank. Costa Rica's bankruptcy laws are not oriented at reorganizing companies, nor does the law provide for an equitable treatment of creditors. In summary, Costa Rica's bankruptcy laws and other commercial laws (such as the collateral law) do not provide a system that facilitates efficient, transparent, and reliable methods for recovering debt.

2. Financial Entities

As is customary throughout the financial world, financial entities such as banks are subject under Costa Rican law to their own bankruptcy provisions. Specifically, in Costa Rica the General Superintendence of Financial Entities (*Superintendencia General de Instituciones Financieras* "SUGEF") has issued rules (SUGEF 24) to govern the liquidation of financial entities. These provisions call for an "intervention" of the troubled financial entity by SUGEF. Unlike other

²⁵ Article 980 of the Civil Code and article 864, et seq., of the Commercial Code.

²⁶ Article 866 of the Commercial Code.

²⁷ Article 939 of the Commercial Code.

²⁸ Article 938 of the Commercial Code.

²⁹ Article 940 of the Commercial Code.

jurisdictions that allow the agency discretion in the appointment of receivers (“*interventores*”), “*curadores*” or “trustees,” SUGEF appoints only its own staff as provisional caretakers of the insolvent institution. This means that the caretaker has little discretion and seldom succeeds in reorganizing and rehabilitating the insolvent entity. When asked about the number of successful bank reorganizations under SUGEF’s supervision in the last 5 years or so, a knowledgeable party could recall only one such instance in more than ten interventions; the remaining nine institutions went into liquidation. The only reorganized bank eventually faced new financial trouble and was ultimately liquidated.

A sharp distinction should be drawn between official or state banks, which are remnants of the original state monopolization of banks and the commercial banks. The remaining state banks enjoy the privilege of deposit insurance assumed by the Costa Rican government, but commercial banks do not have such insurance. This means that most cases of banking insolvency involve private banks. At the same time, however, SUGEF does not have the discretion of arranging for “shotgun marriages” of insolvent banking institutions. As a result of what can only be described as pressure from the state banks, insolvent private banks cannot be salvaged (*salvataje*) by means of administratively directed mergers with or acquisitions by healthy banks. SUGEF seems to have some discretion with respect to the recognition of preexisting debts. As a rule, the *interventor* will reject preexisting executory contracts. Yet, in the case of a prepaid letter of credit or accepted draft whose amount was deposited in escrow by the bank’s customer, the *interventor* has the discretion of accepting the debt and paying the letter of credit. This is specially done when a foreign correspondent bank has confirmed the letter of credit.

Overall, the liquidation of financial entities in Costa Rica is governed by a clear set of rules provided in SUGEF 24. However, the rules give little room for SUGEF to design mechanisms to salvage banks, resulting in the liquidation of all the commercial banks that have ever faced financial problems in Costa Rica. In this respect, Costa Rica’s laws governing bankruptcy and liquidation of financial entities are inefficient and do not strike an appropriate balance between reorganization and liquidation. In turn, this situation does not generate trust in the financial system’s capacity to rehabilitate itself in cases of financial distress—a scenario that may increase the likelihood that Costa Rica may encounter the kind of financial disasters that other Latin American countries have faced in the past.

C. IMPLEMENTING INSTITUTIONS

1. Nonfinancial Entities

Ordinary courts dealing with civil matters have primary responsibility for implementing the bankruptcy legislation for commercial, nonfinancial entities. In Costa Rica, there are no bankruptcy courts because no specialized commercial courts exist. Civil courts decide commercial matters. The courts of appeal are also the courts of civil jurisdiction. The Second Chamber of the Supreme Court of Justice decides appeals to the Supreme Court that are filed pursuant to bankruptcy procedures. Interviewed legal practitioners were asked why no separate bankruptcy courts existed. Their unanimous response was that such courts were neither necessary nor justified in Costa Rica because there are very few bankruptcy cases a year. Most interviewees agreed that merchants prefer to avoid bankruptcy procedures and were more inclined to reach out-of-court agreements with their creditors. Thus, very few judges in Costa

Rica are experienced in bankruptcy matters. On the other hand, interviews with secured and unsecured creditors revealed a widespread perception that bankruptcy is usually a device resorted to by unscrupulous debtors to hide or dispose of significant assets.

Overall, there are no bankruptcy courts, nor is there a separate commercial jurisdiction. Judges of the civil jurisdiction handle bankruptcies. According to local implementation partners and various interviewees, very few bankruptcy proceedings have taken place in Costa Rican history. This is the result of various factors, the most prevalent of which relates to the inability to rehabilitate a company facing financial problems usually because the board of directors of the company and the managers are effectively removed from the administration of the insolvent company. Absent actual cases, judges have very little expertise in bankruptcy proceedings and because of certain limitations in the law, they cannot be creative in proposing solutions to rehabilitate insolvent companies.

2. Financial Entities

The bankruptcy of financial entities involves an administrative phase and a judicial phase, as described below.

Administrative Phase. Financial entities must present monthly reports to SUGEF, who can send a notice to the National Council of Supervision of the Financial System (the “Council”) informing it that the financial entity in question is facing financial difficulties. Usually, according to interviewees, these are cases in which there is clear or suspected suspension of payments, money laundering, or insufficiency of assets with which to meet the entity’s debts. The Council, which is composed of SUGEF, the Superintendence of Pension Funds and the Superintendence of Securities, will then proceed to order the intervention of the entity based on the findings and recommendations of SUGEF.

Pursuant to the order of intervention of the Council, SUGEF appoints a principal and alternate *interventor* to take over the management of the entity. The manager of the entity is removed, and the board of directors loses its powers. The *interventores* then become the judicial representatives of the financial entity and can decide to totally or partially suspend payment of obligations. During the time of suspension of payments, the *interventores* evaluate the situation of the bank, value assets, and determine if the debts are payable. The *interventores* then prepare a rehabilitation plan for Council approval. If the plan is approved, it is immediately implemented; however, if the Council does not approve the plan, the shareholders are called to provide additional capital to the entity or present an alternate plan. If the shareholders cannot provide additional working capital to the financial entity, the Council will order the declaration of bankruptcy and the liquidation of the entity.

Judicial Phase. The judicial procedure applicable to commercial entities also applies to financial entities; however, in the case of a commercial entity, the *interventor* is substituted by a board composed of a representative of the creditors, one of the shareholders, and a representative of SUGEF.

Overall, the rules clearly establish a simple, straightforward administrative procedure to liquidate banks. Personnel at SUGEF are knowledgeable of bankruptcy and liquidation of banks, and they

are very capable of detecting problems within financial institutions and managing liquidation rules. However, the extensive restrictions limiting SUGEF's authority to salvage banks creates an inefficient system for liquidating financial entities in Costa Rica and leads to overall instability in the financial system.

D. SUPPORTING INSTITUTIONS

1. *Curadores*

Upon the declaration of bankruptcy of non-financial entities, the court appoints a principal and an alternate *curador* who, according to the law, must be an attorney.³⁰ According to the interviewees, the law requiring the *curador* to be an attorney has resulted in many problems for bankrupt entities simply because attorneys do not always have the expertise or knowledge of financial and business issues required to better administer the entity.

2. *Interventores*

During the administrative phase of the liquidation of financial entities, the Council appoints a principal and an alternate *interventor*. These *interventores* are usually personnel of SUGEF. According to SUGEF, they tried to appoint a private CPA firm but they were not effective. Since then, *interventores* have been only SUGEF personnel.

3. Additional Institutions

There are no bailiffs or other private or public entities or officials in Costa Rica (other than courts) to carry out enforcement proceedings. Professional and commercial associations have not played any role in legal reform proposals in the bankruptcy sector. Few lawyers are dedicated to bankruptcy because there are virtually no cases of bankruptcy in Costa Rica.

E. SOCIAL DYNAMICS

According to individuals interviewed for this assessment, there are five principal reasons why Costa Ricans do not use the bankruptcy procedure. First, Costa Rica's businesses are mainly family owned, and business people prefer to seek out-of-court agreements. Second, a social stigma is associated to a bankruptcy declaration, and a bankrupt merchant would have a very difficult time reestablishing himself/herself in Costa Rica. Third, bankruptcy legislation in Costa Rica is designed to protect creditors in what is almost inevitably a liquidation procedure, not to keep companies in business by means of reorganization or rehabilitation procedures. Even if such procedures were attempted by means of a voluntary composition, lenders of last resort would not be protected by means of "super priorities" under the current law of secured transactions. Hence, creditors and debtors are encouraged to proceed toward liquidation of the insolvent's assets. This is also stimulated by the fourth factor—that is, the law's directive to remove the management of the insolvent business and the appointment of governmental *curadores*. Only in rare exceptions do merchants reach out-of-court agreements that will allow them to continue heading the company. Moreover, interviewed merchants worry that reforming the existing law will inevitably require the removal of the existing management.

³⁰ Article 873 of the Commercial Code.

Notwithstanding all the problems and shortcomings of the current laws governing bankruptcy, there is neither the interest nor the will to amend bankruptcy laws or to enact a modern standalone bankruptcy law. Interviewers found that bankruptcy and the problems related to it were not highly discussed among participants in the marketplace, whether from the private or public sector.

Companies have found alternate ways to address insolvency. One company created a trust, deposited all its assets into the trust, and later proceeded to call all its creditors; payments to the creditors were made by the trust. A negative implication of this scenario is that some creditors might have been omitted from the agreements. Another company leased all its assets and properties to the lenders for one Colón, and then signed a bill of exchange naming the lender as payee and enabling them to use the bill to execute upon whatever assets remained in the debtor's business at the time of its final default.

These types of non-judicial agreements have a negative aspect of acting as secret liens, or as agreements entered without knowledge of some of the creditors or bona fide purchasers. In any case, these examples show that businesses are attempting to construct alternate legal solutions to avoid applying the bankruptcy law, revealing a need for bankruptcy law reform. However, it must be emphasized that no interviewee suggested that the court system should be reformed to create a separate bankruptcy jurisdiction. When asked about the influence of local bankruptcy proceedings upon CAFTA transactions, those interviewed unanimously recommended uniform bankruptcy and secured transactions rules throughout the region.

The fact that Costa Rica does not have a well-designed insolvency system can generate uneasiness in foreign lenders who have no assurances that, in the event of insolvency of a Costa Rican debtor, they will be able to recover their loans. In addition, an effective insolvency system should facilitate the rehabilitation of companies and provide fast and reliable mechanisms to liquidate those companies that cannot be rehabilitated; this does not happen in Costa Rica. There is effectively no balance between insolvency and rehabilitation in Costa Rica, a factor that does not contribute to the country's financial stability. Consequently, the reform of the legal framework for insolvency in Costa Rica is of utmost importance; this reform needs to be paired with general commercial reform, especially in the area of secured lending.

F. RECOMMENDATIONS

Despite the lack of use of bankruptcy law or precisely because of it, it is very important for Costa Rica to consider modernizing its bankruptcy law and harmonizing it with that of its trading partners in the region and beyond.

Specific recommendations are as follows:

- ♦ Costa Rica should not retain its highly nationalistic approach to bankruptcy and creditors—favoring nationals at the expense of foreign creditors.
- ♦ Insolvent debtors should be given an opportunity to rehabilitate themselves through Chapter 11 types of proceedings. Mexican bankruptcy law has been recently rewritten and provides a good model for Costa Rica.

- ♦ Bankruptcy law in Costa Rica must be reconciled with secured transactions law. A uniform treatment of secured creditors requires a consistent determination of whether perfected security interests can succeed in retrieving collateral from the bankrupt entity's estate or whether secured creditors are downgraded to the status of unsecured creditors once an act of bankruptcy occurs.
- ♦ In the case of financial institutions, "shotgun marriages" (or *salvataje*) should be allowed to proceed at the discretion of sound supervisors of the financial entities.
- ♦ A need exists for professional *interventores* and *curadores* (i.e., officials or private-sector specialists who are highly familiar with the business of the troubled enterprise).
- ♦ Judges should receive better training on the meaning and consequences of sound asset management, along with greater powers to detect and reverse fraudulent conveyance of assets.
- ♦ Much would be gained if a uniform *regional* bankruptcy law were to be adopted under the guidance of the World Bank's recently drafted principles and best practices of insolvency regulation. These principles have been drafted by some of the world's most respected experts on bankruptcy law and practice, and their adoption would automatically ensure an improved credit rating for the Central American nations.

IX. COMPETITION POLICY

A. INTRODUCTION

A state-led model of growth created a situation of relative prosperity in Costa Rica, but over time the model proved unsustainable. Costa Rica has increasingly been unable to balance its budget and has seen an ever-increasing growth of government debt. To combat these difficulties and increase Costa Rica's competitiveness, in the past 15 years the country has been engaged in deregulation, liberalization, and privatization. Included in these market reforms were the introduction of a competition law in 1994, and the establishment of a competition agency one year later. This law interacts with other reforms to create a more market-friendly economic environment.

B. LEGAL FRAMEWORK

Competition is governed by the Law on Promotion of Competition and Effective Defense of Consumers No. 7472 of December 20, 1994, and accompanying regulation (Decree 25234 of January 25, 1996.)³¹ A notable limitation of the law is exemptions for state monopolies and public services concessions.³²

1. Agreements and Dominance

Like Mexico, Panamá, the United States, and many other jurisdictions, Costa Rica distinguishes between horizontal cartel agreements and other agreements. The law provides that the most egregious forms of anticompetitive agreements, including price-fixing, bid-rigging, and allocation of territories or customers are per se illegal. (In Costa Rica, as in Panamá and Mexico, per se practices are called "absolute monopolistic practices," as opposed to the other forms of agreements, referred to as "relative monopolistic practices.") "Absolute monopolistic practices" or "per se illegal" means that the Prosecutor/plaintiff has to prove only that the agreement was

³¹ The Constitution also contains several provisions related to competition. Article 46, found in the title on Individual Rights and Guarantees, prohibits "private monopolies, as well as any act, even if originated by virtue of law, which may threaten freedom of trade, agriculture, or industry." It declares that "[a]ction by the State to prevent monopolistic practices or tendencies is in the public interest." It provides that de facto monopolies, i.e., natural monopolies, shall be governed by special legislation, and that new state or municipal monopolies require a two-thirds vote by the Legislative Assembly. It also recognizes a right of consumer protection. On the other hand, in the title on "Autonomous Institutions," Articles 188 through 190 protect state monopolies. Article 189 constitutionalizes the status of state banks and state insurance institutions as autonomous institutions. The article also allows the Legislative Assembly to establish other state and private monopolies by a two-thirds vote. Managed by their directors, autonomous institutions "enjoy administrative independence and are subject to the law in matters of government," Article 188. According to Article 190, before passing laws concerning an autonomous institution, the Legislative Assembly must hear the opinion of the affected entity.

³² In principle, state-owned monopolies are prohibited and sanctioned. However, the following state entities cannot be sanctioned for performing anti-competitive acts: a) concessionaries rendering public services, and b) state monopolies created by law, including insurance, banking deposits in checking accounts, alcohol distillation and commercialization for internal consumption, distribution of fuels and the telephone services, telecommunications, electrical distribution and water. The law does not allow ordinary legal action against state entities for anti-competitive acts. Monopolies in the public sector (state monopolies) are regulated by the Authority in charge of Regulating Public Services (*Autoridad Regulatoria de los Servicios Públicos* or ARESEP).

made. It is no defense that the agreement was not carried out or that it did not have an anticompetitive effect. Nor does the Prosecutor/plaintiff have to prove that the defendants had sufficient market share to raise prices or reduce output. Use of such a rule is commendable, because it eliminates the necessity for the Prosecutor or victim to prove that prices are higher than they would have been without the agreement or that prices are unreasonable, and it provides clear guidance for businesses and simplifies the judicial process.

Relative monopolistic practices, including noncartel and vertical agreements and practices, require proof of market power and anticompetitive purpose or effect. Sufficient guidance is provided on means of determining the relevant market and market power.

2. Mergers

The law entrusts jurisdiction over mergers to Commission on Promotion of Competition (Comisión de Promoción de la Competencia) (COPROCOM), allowing the Commission to initiate a merger investigation within 6 months of consummation of the transaction. The law and accompanying regulation, however, provide little guidance for the business community as to what types of transactions are prohibited. The law does not provide for merger notification. The development of merger guidelines appears necessary to assist both the Commission and the business community. Also, the Commission expressed concern over difficulties it had in learning of mergers, and therefore a merger notification system may be considered. To that end, the system should reflect the International Competition Network's Recommended Practices for Merger Notification and Review.

3. Penalties

According to Article 28 of the Competition Act, the Commission may impose the following penalties: (a) suspension, correction, or suppression of the conduct or merger in question; (b) divestiture and/or dissolution of mergers with or without a fine; and (c) monetary sanctions. If a party is not satisfied with the Commission's ruling, it may resort to courts and seek a review of the decision. While the case is tried, the decision remains in force.

Monetary sanctions for absolute monopolistic practices include fines up to 680 times the amount of the lowest minimum monthly wage.³³ For relative monopolistic practices and for prohibited mergers, fines up to 410 times the amount of the lowest minimum monthly wage can be imposed. Monetary sanctions on individuals (persons who directly participate in a prohibited merger or monopolistic practice, on behalf or by order of legal persons, or informal associations) can be fined up to 75 times the amount of the lowest minimum monthly wage. In case of particularly egregious conduct, the Commission may impose additional fines of 10 percent of the previous fiscal year's annual sales or 10 percent of the value of the assets of the transgressor. Finally, providing false information to the Commission can incur a fine up to 65 times the lowest minimum monthly wage. Delaying the delivery of the information requested by the Commission

³³ The actual amount of the lowest minimum monthly wage is ₡109,543 (approximately US\$245).

can incur fines up to 50 times the lowest minimum monthly wage. The judiciary collects the fines. Failure to pay the fines may give rise to criminal liability.³⁴

Individual liability and criminal liability appear to be important components of the law. Information gained from interviews with COPROCOM management indicated that as of October 2004, there were 16 economic agents involved in 3 different cases that were being prosecuted in court. As described further below, success in collecting fines is attributed to the threat of criminal sanctions.

One area where penalties could be improved is an increase in the maximum fines, because low fines can often be regarded as the cost of doing business.

C. IMPLEMENTING INSTITUTIONS

COPROCOM was established in 1995 to implement the competition law and is an administrative body within the Ministry of Economy, Industry, and Commerce. The Commission is dependent on the Ministry for budget and other financial matters but is independent from the Ministry for decision-making, enforcement, and advocacy activities. Investigations and first-level decision-making are conducted within the Commission, with appeals of the Commission decisions to courts of general jurisdiction. The Commission is composed of 10 members, with a 10-person technical unit that carries out investigations.³⁵

In 9 years, with extremely limited resources, COPROCOM has been enormously successful in transitioning much of the business community and parts of the government from an anti-competition stance toward a culture that is both aware of the benefits of competition, and mostly supportive of competition law and policy. This success can be attributed to adherence to a twofold agenda: careful selection of cases that build support for competition, and dedication to competition advocacy among the business community, consumer groups, and other government bodies.

The Commission has the authority to select which cases it chooses to pursue and has used this ability wisely. COPROCOM acknowledged early on that with its limited resources, it would not be able to pursue all allegations of anticompetitive practices.³⁶ Instead, the Commission has selected carefully those cases it chooses to pursue with a view toward building a competition culture: it investigates cases that will attract attention from the media and win popular support for the agency. COPROCOM works closely with the press, in particular, during its investigations. Through prudent selection of cases and successful enforcement, COPROCOM

³⁴ Article 54 of Law No 7472, The Law of Promotion of Competition and Effective Defense of Consumers of December 20, 1994.

³⁵ Although extremely limited in number, there is low turnover in COPROCOM's staffing. In 2001–2003, only two professionals left the agency.

³⁶ In 2001, the Commission investigated 28 cases of anticompetitive conduct and reviewed one merger. In 2002, the Commission opened 15 new investigations of anticompetitive conduct and completed 18 investigations. In the same year, the Commission received 58 requests for investigations, consultations, advisory opinions, and licensing and resolved 60 of the outstanding requests. In 2003, approximately 32 new investigations of anticompetitive conduct were initiated, and 28 completed, as well as one merger investigation that was opened and completed. Including consultations, advisory opinions, licenses, etc., the Commission received a total of 82 new requests and completed 74 of existing or new requests.

has made significant progress in gaining legitimacy for the agency, and building support for competition policy.

The Commission's success in enforcement can be measured in part by progress in the ability to pursue a variety of types of cases, as well as the aggressiveness with which it imposes penalties.³⁷ The Commission's enforcement actions initially focused on cartel cases but gradually have transitioned toward more complicated abuse of dominance cases. Regarding penalties, the increased aggressiveness is most apparent in the area of monetary sanctions.³⁸ In 1995, COPROCOM imposed monetary fines totaling US\$62,033. In 1999, the Commission imposed fines of US\$123,697. As was learned during interviews conducted by the assessment team, by 2002, fines amounted to US\$419,918. In the first half of 2004, the Commission had already imposed fines of US\$168,500.

In the area of advocacy, COPROCOM's success is noteworthy. In the initial years of COPROCOM's existence, there was little understanding of competition law among the business community, government, and the general public. The first years were devoted almost exclusively to competition advocacy, by holding seminars for consumers, the public sector, and the business community that explained the fundamentals of competition law.³⁹ In recent years, COPROCOM has engaged in much more focused advocacy initiatives. For example, the Commission is holding training sessions for the judiciary, in an effort to improve decision-making in appeals. In the past year, the Commission has worked closely with consumer associations and regulators to provide them with the theoretical tools necessary for understanding anticompetitive practices, so they will know when to file a complaint with the agency. These efforts have already translated into tangible results. Earlier this year, COPROCOM held seminars for regulators, including the pension regulators. Last month the pension regulators informed COPROCOM of alleged anticompetitive practices and requested that COPROCOM open an investigation, marking the first time the pension regulators had reported anticompetitive practices.

One way COPROCOM educates the business community and others is through publication of a monthly newsletter that describes current activities of the Commission, including descriptions of COPROCOM's decisions in important cases. Efforts to increase awareness with the business community have been at least partially successful; many of the large companies in Costa Rica now have programs that monitor their compliance with the competition law.

³⁷ Generally, the Commission imposes a combination of penalties that include monetary sanctions and behavioral remedies. For example, in a recent investigation involving the market of palm oil, the Commission imposed a fine of approximately ₡110,000,000 for three horizontal agreements and ordered an injunction against the conduct. The Commission also imposed a fine on the managers involved in the cartel. Although the Commission's decision was appealed to the courts, the companies paid the fines and stopped the conduct while waiting for appeal. In another recent example, the Commission issued a series of obligations on a nonalcoholic beverage company for abuse of dominance and fined the party approximately ₡68,000,000. The party, instead of appealing directly to the courts, requested review of the decision by the Commission, which is currently ongoing.

³⁸ The Commission attributes its success in collecting fines to the provision allowing criminal penalties.

³⁹ The focus on advocacy is reflected in case statistics: in 1995, the Commission received 16 requests for, and resolved 9, investigations, advisory opinions, etc. In 2003, the Commission received a total of 82 requests and resolved 74 of them.

Finally, advocacy initiatives with the general public appear to be working. The public seems to be better informed about the benefits of competition. For example, there is growing dissatisfaction among consumers with the public monopolies, whereas 10 years ago, the majority of consumers supported these monopolies. In addition, the number of complaints that agency receives has grown considerably in the past 9 years.⁴⁰

COPROCOM's success, however, has not led to any significant increase in agency resources, and the biggest challenges faced by the agency can be attributed to limited resources.⁴¹ COPROCOM lacks sufficient personnel to pursue more than a few cases at a time and does not have staff trained in specialized areas of competition policy, for example, in regulated sectors. Agency staff need more training than they currently have in investigation techniques and analysis of competition cases, in particular in regulated sectors such as telecommunications, insurance, financial services, transportation, and intellectual property.

The Commission also needs to improve its guidelines for the private sector. While large companies are making efforts with the competition law, many small businesses remain ignorant of the law.

D. SUPPORTING INSTITUTIONS

1. Judiciary

The first external appeal of COPROCOM's decisions is to the courts of general jurisdiction, with secondary appeals to the higher courts. The judiciary, as a whole, issues decisions in a transparent, nondiscriminatory, efficient, and honest manner, without regard to inappropriate political pressures or nonjudicial considerations. The majority of the judges, however, have little to no understanding of competition law, and at least higher court judges would benefit from basic training programs.

2. Legislative Assembly

In principle, the Legislative Assembly supports the opening of markets, as well as the establishment of clear rules to eliminate anticompetitive practices, yet commitment may be questionable considering that the Assembly has delayed privatization of state monopolies and concessions. Although the current Assembly is primarily concerned with fiscal reform and the approval of CAFTA, if CAFTA is implemented, the Assembly will be more likely to engage in pro-competition policy activities.

3. Professional Associations

Many professional associations have not developed mechanisms to denounce anticompetitive practices, although COPROCOM is working to establish these mechanisms. Professional bar associations and other associations do not actively participate and work to deter anticompetitive

⁴⁰ As discussed *supra* note 36, the Commission received 16 requests in its first year, 1995. In 1998 this number was 52. In 2003, the Commission received 82 requests for decisions, investigations, consultations, advisory opinions, licensing, etc.

⁴¹ The total budget for COPROCOM was US\$170,000 in 2001, \$180,000 in 2002, and US\$205,000 in 2003.

practices. Accordingly, they do not provide much information to the public concerning competition policies in market economies.

Commerce and industry chambers (Chamber of Industry, Chamber of Commerce, Chamber of Carriers, and the Construction Chamber, among others), however, have become watchdogs for anticompetitive practices and support the development of the competition law-policy.

4. Universities and Think Tanks

Various universities offer a limited number of courses on competition policy and law and consumer rights. With the occasion of the negotiation of CAFTA and the incorporation of Costa Rica to the World Trade Organization (WTO), the national press has prepared various supplements on anticompetitive practices and their impact on the national economy. More efforts could be made, however, to promote additional competition courses at the university level.

Independent entities, such as Ecoanálisis, Centro di Fisica degli Stati Aggregati (CEFSA), and INCAE, do contribute to developing a more competitive environment. These entities follow the economic tendencies of the market and publish studies on competitiveness.

E. SOCIAL DYNAMICS

Costa Rica was the first of the CAFTA countries to enact a competition law. Ten years later, implementation of this law has resulted in many successes relative to the resources devoted to its enforcement. COPROCOM and other supporting institutions have contributed to creating a culture of competition. For example, although de facto monopolies still exist, the fact that they are more likely to be “disguised” reflects a change in public understanding. The public is generally aware that anticompetitive practices are illegal. Successful enforcement, advocacy, and educational initiatives are having an impact on the behavior of at least the largest companies.

The government’s commitment to competition policy, however, is questionable. Liberalization, for example in telecommunications, is gradual. Funding for COPROCOM remains woefully inadequate. Observers are left wondering if the competition law and other reforms were merely formalistic when they were enacted.⁴² Either way, COPROCOM and supporting institutions have made noteworthy progress in demonstrating to the outside world Costa Rica’s commitment to competition policy. If CAFTA is approved there will be considerable pressure from within the country and externally for the government to demonstrate serious dedication to a market economy, which will likely have positive effects for competition law-policy.

⁴² The situation in the banking sector is illustrative of the gap between anticompetitive principles and practice. Legislation enacted in 1987 allows the formation of private banks. There are three state banks and 14 private banks, 13 of which are part of one group. On the one hand, deposit insurance does not exist; yet, as the Superintendent of Financial Institutions observed, deposits in the state banks enjoy an implied government-backed insurance. That implication provides such a competitive advantage to state banks that it greatly inhibits the formation and growth of private banks.

F. RECOMMENDATIONS

- ♦ With a view toward convergence with international best practice (as formulated by the International Competition Network, OECD, and others), review national legislation, and propose specific amendments to improve it.
- ♦ Increase efforts to allocate additional resources to COPROCOM via a twofold strategy: providing educational tools for the legislature on the benefits of competition law, and building awareness of the shortage of resources among stakeholders (chambers of commerce, associations, consumer organizations, etc.)
- ♦ Elaborate and improve COPROCOM's staff manuals and private sector guidelines, particularly in areas such as analyzing anticompetitive conduct and mergers, competition law in regulated sectors, and the treatment of confidential information.
- ♦ Conduct training for agency staff in investigation techniques and analysis of competition cases, in particular in regulated sectors such as telecommunications, insurance, financial services, transportation, and intellectual property. Training should be conducted through long-term internships in more experienced agencies, or through the engagement of a long-term advisor.
- ♦ Supplement advocacy initiatives with concrete studies of competitiveness in Costa Rica. Prepare case studies of the decisions taken by COPROCOM and the impact of these decisions on the affected sector.
- ♦ Equip COPROCOM and CNC with additional infrastructure, including better information systems and case handling software.
- ♦ Hold weeklong training sessions for high-level judges with judges from more mature jurisdictions.
- ♦ Develop training sessions for sectoral regulators as well as for public sector personnel involved in government procurement.
- ♦ Increase the number of competition policy-related courses at the university level, including training a sufficient number of Costa Rican academics, so that Costa Rica can serve as a regional training center for Central America. One way to do this is through exchanges between Costa Rican and foreign university professors.

X. INTERNATIONAL TRADE

A. INTRODUCTION

Although to some extent Costa Rica is still dependent on agricultural production and exports — sugar, bananas, coffee, fruits, flowers, ornamental plants — and on textiles and clothing, the country has been successful in developing a thriving manufacturing sector. Investors benefit from the largely educated workforce,⁴³ the relative stability of the country, and its democratic tradition. Costa Rica expanded its economy in the late 1990s to include strong technology and tourism sectors.⁴⁴ In the late of the 1990s, Costa Rica's foreign trade showed a clear upward trend, with growth in the trade in goods totaling 7.65 percent between 2000 and 2004, while agricultural exports fell from 68 percent of total exports of goods in 1995 to 23.4 percent in 2004.⁴⁵ This major shift in agricultural exports was mainly due to the establishment of Intel Corporation's US\$200 million microprocessor finishing and testing facility, a general increase in industrial exports, and the stagnation in the world price of traditional agricultural exports such as coffee. In the agriculture sector, coffee continues to be the most important export, although the country also exports melons, pineapples, foliage and ornamental plants, among others.

The main destination of Costa Rican exports continues to be the United States. The share of exports of goods to the United States was 42.2 per cent in 2004. In addition, the launch of the free trade agreement between Costa Rica and Mexico coincided with a significant increase in trade between the two countries, representing an increase of Costa Rican exports to Mexico from 0.6 per cent of all goods exported in 1995 to 2.1 per cent in 2003. Modular circuits, palm oil, textiles, and aluminum sheets and wire were the main goods exported to Mexico.⁴⁶

The European Union continues to be the second destination for Costa Rican products, although its relative share has declined perceptibly, falling to just more than 17 percent in 2004.⁴⁷ In the European Union, the strongest trading partners with Costa Rica are the Netherlands and the United Kingdom. Both countries have significantly increased their imports, representing 60 percent of Costa Rican exports to the European Union.

However, the products traditionally exported to the European Union, coffee and bananas, have declined in relative importance vis-à-vis modular circuits and other nontraditional goods such as pineapples, ornamental plants and foliage, melons, and prawns.⁴⁸

⁴³ Costa Rica's estimated population of 3.9 million people as of July 2004 is 96 percent literate.

⁴⁴ CIA, *The World Factbook*, Costa Rica, at <http://www.cia.gov/cia/publications/factbook/geos/cs.html#Econ>.

⁴⁵ World Trade Organization, Trade Policy Review Body, *Trade Policy Review—Costa Rica, Report by the Secretariat*, 2001.

⁴⁶ *Id.*

⁴⁷ Promotora del Comercio Exterior de Costa Rica (PROCOMER), 2004 available at http://www.procomer.com/est/mercados/libro_2004.cfm

⁴⁸ *Id.*

B. LEGAL FRAMEWORK

1. General Environment for Trade

Costa Rica ratified General Agreement on Tariffs and Trade (GATT) in June of 1987 and became a contracting party on November 24, 1990. The country ratified the Marrakech Agreement on December 26, 1994, thereby becoming a founding member of the WTO.⁴⁹

Costa Rica is a member of the Central American Common Market (CACM), which also comprises Guatemala, Honduras, El Salvador, and Nicaragua. The basic instrument of the Central American Economic Integration Program, which envisages the establishment of the Central American Common Market, is the General Treaty on Central American Economic Integration of December 1960. To achieve a common market, the treaty provided for the completion of a Central American free trade area⁵⁰ and the adoption of a common Central American tariff. On October 29, 1993, the five countries signed the Protocol to the General Treaty on Central American Economic Integration, referred to as the Guatemala Protocol,⁵¹ pursuant to which they agreed to the gradual and progressive establishment of a customs union.

Costa Rica has also signed free trade agreements with the United States (CAFTA), Mexico,⁵² Chile,⁵³ the Dominican Republic,⁵⁴ Canada,⁵⁵ and CARICOM,⁵⁶ and has signed a number of bilateral investment treaties.

CACM's most significant achievement in common customs legislation has been the agreement on a new common customs code, the Central American Uniform Customs Code (*Código Aduanero Uniforme Centroamericano*, or "CAUCA III") and the regulations thereto (*Reglamento del Código Aduanero Unificado Centroamericano*, or "RECAUCA III"). Both CAUCA III and RECAUCA III have been implemented in Costa Rica, the only CACM country to have amended its domestic legislation consistent with CAUCA III/RECAUCA III.

2. Domestic Laws

Costa Rican customs practice is governed primarily by the *Ley General de Aduanas* of 1995, as amended in 2003 ("LGA"), and by the *Reglamento de la Ley General de Aduanas* of 1996 as amended in 2004 ("RLGA"). CAUCA III and RECAUCA III are also in force in Costa Rica, although relatively little attention is paid to the Central American code. The LGA and its

⁴⁹ www.wto.org.

⁵⁰ As of 2003, 99.2 percent of goods are freely traded among the CACM countries under this agreement; 0.7 percent goods are excluded, and there are import controls on 0.1 percent of goods.

⁵¹ *Protocolo al Tratado General de Integración Económica Centroamericana*, dated October 19, 1993.

⁵² This agreement, which entered into force January 1995, provides for immediate elimination of duties on 73 percent of goods, phase out over 5 years on another 9 percent (already completed), phase out by 2005 on 12.5 percent goods, and phase out by 2010 on 0.4 percent. 1.8 percent of goods are excluded.

⁵³ This agreement entered into force February 2002 and provided for free trade in 73.4 percent of goods.

⁵⁴ This agreement entered into force March 2002 and provided for immediate liberalization of trade in 91.2 percent of goods.

⁵⁵ This agreement entered into force November 2002 and provides for immediate free trade in 65.1 percent of goods, with the duties on remaining goods being phased out in 8, 9, and 15 years.

⁵⁶ The agreement with CARICOM is still pending ratification.

regulation are the regulations consulted on a daily basis. In addition, Costa Rica enacted a law to regulate the free trade zones in 1990, which was modified in 1998. Most interviewees, from both the private and public sectors, indicated that the problems in the international trade sector do not stem from the lack of legislation; if anything, there is excessive regulation. Except for a few minor changes that may be required, the laws are clear as to the definition of the mandate of government entities involved in international trade, and such laws are public and widely known by all sectors (laws and regulations must be published in an official gazette to become enforceable).

3. Tariff Regime

Costa Rica applies the Central American Import Tariff, containing the classification nomenclature (*Sistema Arancelario Centroamericano*, SAC), together with the import duty rates and the rules for the application of its provisions. This tariff is common to the member countries of CACM. The SAC is based on the Harmonized Commodity Description and Coding System (HS). The third revision of the HS (the 2002 amendments) was incorporated into the SAC by the CACM countries effective October 2002. Costa Rica has four basic duty rates: 0 percent, 5 percent, 9 percent, and 14 percent. However, certain sensitive products are subject to higher rates. Tariff rate quotas are used for some sensitive agricultural products such as corn and beans. There is also a value-added tax of 13 percent and an import tax of 1 percent.

4. Other Trade Rules and Laws

- ♦ **Services.** Costa Rica's insurance, telecommunications, electricity distribution, petroleum distribution, potable water, sewage, and railroad transportation industries are state monopolies. Restrictions preclude foreign companies from participating in certain sectors such as customs handling, medical services, and other professions requiring Costa Rican registration and long-term residency of the persons providing the services.⁵⁷
- ♦ **Antidumping, countervailing, and safeguard measures.** Costa Rica adopted the Central American Regulations on Unfair Trade Practices (Executive Decree No. 24868-MEIC of 19 December 1995), which entered into force in Costa Rica on 12 January 1996. The Ministry of Economy, Industry, and Commerce (MEIC) conducts all administrative investigations involving the possible imposition of antidumping duties, countervailing duties, or safeguard measures.

According to WTO statistics, between 1 January 1995 and the end of 2003, Costa Rica had initiated only six antidumping duty investigations. The private sector indicated that there is significant dumping in Costa Rica, but that it is very difficult to prove; hence, companies do not seek to commence relevant procedures under the corresponding legislation. When asked why there was difficulty in obtaining proof, they said that this was mostly due to lack of resources of the MEIC and to the lack of trained personnel.

- ♦ **Free Trade Zones.** There were no specific concerns of the interviewees concerning free trade zones. The Ministry of Trade administers the permits to set up a company within

⁵⁷ United States Trade Representative, <http://www.ustr.gov/reports/nte/2004/costarica.pdf>. Report on Trade Barriers, Costa Rica, 2004.

the free trade zone, and the private sector indicated that the process was transparent and expeditious.

- ♦ **Export Subsidies.** Incentives for nontraditional exports, including tax credit certificates (CATs) formerly granted, were phased out in 1999. Allegedly, there are no longer export subsidies. However, in the free trade zones, goods are exempted from income taxes and there remain duty waivers on machinery and equipment, which are generally export subsidies.
- ♦ **Importation Certificates.** Lawyers representing private sector clients stated that it is currently simple to obtain standard sanitary and phytosanitary (SPS) documentation from the Ministry of Agriculture. In effect, they indicated that the SPS documentation can be obtained for foodstuffs in 3 days and for medicines in approximately a week, and they assured us that the certificates were not being used as a nontariff barrier. However, researchers who were focusing on customs procedures found that interviewed importers felt that the opposite was the case in Costa Rica. They complained that the process to obtain documentation from the Ministry of Agriculture or the Ministry of Health was lengthy and complicated.

Overall, Costa Rica's laws regulating international trade are modern and generally comply with the provisions of the international trade agreements—including regional agreements—to which the country is party. However, the customs legislation has some gray areas that give the Customs Service much room for interpretation. In some limited cases, the provisions of the national customs law and the regulation are contradictory, while in others such legislation contradicts regional instruments, in part because Costa Rica has made many reservations to the regional legislation. In addition, it can be difficult to adapt the laws to the modernization of the Customs Service and the implementation of the new automated Customs system (discussed below), because all changes require following a cumbersome process in Congress. Overall, however, people interviewed as part of this assessment indicated that the legal framework is sufficient.

C. IMPLEMENTING INSTITUTIONS

1. Ministry of Foreign Trade

The main entity in charge of foreign trade policymaking in Costa Rica is the Ministry of Foreign Trade ("COMEX"), which has a clear mandate under its law of creation (Law 7638) to perform a number of functions: policymaking in matters of international trade and foreign investment, negotiation and signing of bilateral and multilateral agreements, representation of the country at the WTO and other international fora dealing with trade issues, and establishment of the mechanisms to regulate exports and investment, among others.

COMEX offers information concerning applicable multilateral and bilateral trade and investment agreements on its webpage,⁵⁸ which also contains a copy of the law of creation and the regulation on internal organization of COMEX. The page also has information concerning the current trade negotiations in which Costa Rica is involved.

⁵⁸ See <http://www.comex.go.cr>.

The private sector indicated that COMEX is a very strong and powerful government entity, that their personnel are very well trained and knowledgeable, and that they have sufficient funding. The only concern, pointed out by one interviewee, was that COMEX had too many obligations, and because it was currently focusing on the negotiation of trade agreements, it was not sufficiently promoting foreign investment. However, during our interviews with COMEX officials, they explained that although the general public believes they have enough funds and personnel, because they compare them to other ministries, COMEX needs more personnel, better offices, and more funds.

Because COMEX is a relatively new government entity, its personnel are well trained and have modern views about the benefits of free trade and increased foreign investment. Although COMEX officials feel they need more funds, more personnel, and better infrastructure, COMEX functions reasonably well, and it is considered the elite ministry of Costa Rica.⁵⁹

COMEX officials have made a great effort to address the negotiating process from the bottom up, rather than following the traditional top-down approach of implementing trade agreements (which they identified as the approach taken by the European Union). The “bottom-up” studies undertaken by COMEX have shown that there are many small details and obstacles to trade that need to be resolved for effective free trade. COMEX has completed the relatively easier task by negotiating and signing CAFTA and is now faced with the harder task of working on changes to make its implementation possible. COMEX is aware of the need to harmonize many laws at a regional level and, enact more regional laws, improve trade infrastructure, educate the general public, and provide training to public officers. Officials in COMEX believe there are two approaches to solving the problem in Customs: (a) provide training to the current officers; or (b) start from zero, through the training of completely new staff and personnel for Customs. Many in COMEX lean toward the second approach.

COMEX now faces the challenge of implementing phases two and three of its National Action Plan presented to the Trade Capacity Builders during the CAFTA negotiations. These phases are: (a) implementation of institutional strengthening and (b) transition to free trade.

2. Other Entities Directly Involved With International Trade

- ♦ Promoter of Foreign Trade of Costa Rica (*Promotora de Comercio Exterior de Costa Rica*, or “PROCOMER”)⁶⁰ resulted from the merger in 1996 of the Center for the Promotion of Exports and Investment and the Corporation of Free Trade Zones. The purpose of PROCOMER is to develop and strengthen the exporting capacity of Costa Rican productive sectors.
- ♦ MEIC is responsible for conducting all administrative investigations involving the possible imposition of antidumping duties, countervailing duties, or safeguard measures.

⁵⁹ Since June, the country has experienced a political crisis marked by the resignation of Alberto Trejos, Minister of COMEX; Anabel González, chief negotiator of the CAFTA; and the Ministers of Transport, Finance, Labor, and the Presidential Minister, among other officials. See for example, Oneworld.net, *Protests Bring Costa Rica to the Verge of Paralysis*, (Aug. 26, 2004), at <http://www.oneworld.net/article/view/92654/1/>.

⁶⁰ See, <http://www.procomer.com/>.

According to the private sector, the entity is insufficiently funded, and most of the dumping and subsidies cases in Costa Rica go unchallenged.

- ♦ Ministry of Health and Ministry of Agriculture are related insofar as it is required to grant a series of documentation necessary to import certain types of goods into the country. There have been contradictory views from the private sector regarding these entities. Interviewers were told by some that the ministries are both efficient and speedy in granting all necessary documentation, while other sectors blame them directly for the delays in imports and the protection of cosmetic producers.

The abovementioned entities, as well as the rest of the public administration, derive their mandates from the applicable legislation. They must issue decisions required by such legislation in accordance with laws,⁶¹ which become enforceable through publication in the official gazette.⁶²

Overall, the general public is very pleased with COMEX and PROCOMER, with their open-door policies that allow the private sector to easily communicate with the public sector, their bottom-up approach, and with their efforts to negotiate conditions in the trade agreements that are beneficial to domestic producers. However, the private sector feels that more needs to be done in the area of trade capacity building of local entities and promotion of foreign investment.

D. SUPPORTING INSTITUTIONS

1. Customs Service

Article 8 of the General Customs Law creates the *Servicio Nacional de Aduana* (the National Customs Service) as an entity of the tax administration and a dependency of the Ministry of Finance. The Customs Service comprises the general directorate, the Customs houses, and other Customs entities.⁶³ Customs' legal mandate is clear and adequate. However, Customs is understaffed, and Costa Rican Customs procedures remain complex and bureaucratic, despite recent legislative changes and improvements. Customs applies published norms (laws and regulations) uniformly throughout the country. However, Customs also applies certain internal Customs provisions, called circulars (*circulares*), which are generally not published in the official gazette, although some are available on Customs' webpage through the *Buscador de Documentos* (BUDHA)⁶⁴ service, in an inconsistent manner. Customs also established the "ventanilla única".⁶⁵

Costa Rica lacks a clear risk-assessment methodology. The country does not have a computerized database to assist Customs in determining which shipments must be inspected. The port infrastructure and other Customs infrastructure (such as warehouses) are very deficient. In

⁶¹ Article 13 of the Public Administration Law.

⁶² Article 7 of the Civil Code.

⁶³ General Customs Law, article 8 (<http://www.hacienda.go.cr/aduanas/LGA/LGA003.HTM>).

⁶⁴ BUDHA is the document search engine of Customs, which was created with support from the Costa Rican Chamber of Exporters.

⁶⁵ The "One-Stop Shop". Interviewees explained that the purpose of the single window is to issue at one location all the permits associated with importing. However, some permits (for example, from the Ministries of Health and Agriculture) still need to be obtained separately.

addition, there are no immediate plans to invest in improving infrastructure either by the public sector or from some donor agencies.

Electronic declarations work sufficiently well. The country is implementing a new automated Customs system based on the Uruguayan model (LUCIA), which is referred to as TICA in Costa Rica, and is set to commence at the end of this year. Although there is much optimism within Customs about the use of this system, more training is required to fully and effectively implement the system. Government officials feel that donor agencies go as far as providing the technology (not only in the LUCIA/TICA case but in other cases), but they do not ensure that Customs officers receive the proper training on how to use the systems.

In addition, the private sector and Customs have worked together to achieve more transparency concerning applicable rules and regulations by creating the Internet-based service called BUDHA, which is a database containing all the applicable Customs norms, whether or not published in the official gazette. However, many custom houses have only one computer, and often officials cannot access the Internet.

Overall, the majority of the private sector and donor agencies interviewed believe that Customs has many problems that will make it difficult to implement CAFTA. The main concerns include the following:

- ♦ **Corruption.** Corruption stands out as the most frequently mentioned problem within Customs. Most of the interviewees indicated that much needed to be done to eliminate corruption. One interviewee expressed the view that the best approach would be to eliminate the entire infrastructure and dismiss all employees and start from zero, because there was no possible way of solving the problem of corruption with current officials. Other sources blamed corruption mostly on the Customs brokers and indicated that in many cases, corrupt payments requested by Customs brokers to supposedly pay Customs officials remain in the hands of the brokers themselves. Others blamed the union of port employees for corrupt practices. Interviewees commented that Customs officials have too much discretion and powers granted by law, and that there are no clear criteria for determining when a shipment should be stopped for inspection. This leaves room for officers to stop cargo for no reason and to request payments to release the cargo.
- ♦ **Training of customs officials.** In general, interviewees feel that the key problem in the area of tariff classification derives from the lack of training of Customs officials to determine the correct tariff classification applicable to a given product. Many importers take advantage of this weakness to classify goods under incorrect subheadings with lower duty rates. This has resulted in a loss of revenues for Costa Rican Customs. Notwithstanding the complaints by the private sector, many also indicated that neither the public sector nor the private sector is active in providing training to Customs officials to help them classify the goods correctly.
- ♦ **Security.** The problem with Customs security came up at various times during our interviews. When asked what type of security they were referring to, some indicated that it was the security of the cargo; they said that many times the seals are broken and people (both from the Customs house or passersby) would open the containers prior to their inspection. Others indicated that it was the security of the Customs precinct itself in some

Customs houses only. Others indicated that, due mostly to a lack of training, Customs officials are not able to detect illegal drugs, counterfeit and pirated goods, or terrorist activities. There is no methodology for risk analysis and targeting (which is an open door for corrupt practices from Customs officials).

- ♦ **Poor conditions of the Customs infrastructure.** Contradictory stories emerged during the course of this assessment about the conditions of the Customs infrastructure and the reasons no one has financed structural improvements. Sources indicated that Customs has no warehouses near the ports, and thus the cargo has to be transported to San José or another city. Another source mentioned that although there are indeed official warehouses near the main ports, they are insufficient to meet demand. Finally, a third source told us that there are no Customs warehouses, but instead there are many private warehouses. The fact that clarity is lacking with respect to the real conditions of the Customs infrastructure is a problem in itself. In any case, most interviewees said that the Customs infrastructure generally is very poor and much needs to be done to modernize it.
- ♦ **Lack of coordination.** There is lack of coordination with other entities involved in import and export operations, and there are excessive procedures and documentation requirements.
- ♦ **Transparency.** Customs officials base many of their decisions on the previously mentioned unpublished circulars. Furthermore, importers and exporters are often confused about which circular is applicable at any given time, and that customs houses apply circulars that may have been cancelled, if they are more beneficial to a given importer. This has promoted “customs-shopping,” whereby an importer may move the cargo from the port of arrival to another port for clearance, just to benefit from a more lenient but out-of-date circular that is being applied by the Customs house at that port.

2. Professional Associations and Specialized Services

There are many individual lawyers and economists in Costa Rica with expertise in matters of international trade. The Costa Rican bar association, however, does not have a section dedicated to international trade issues. The private sector is organized into chambers and trade associations, but many interviewees indicated that the chambers have not been active in promoting changes to the laws and the modernization of institutions. Chamber representatives indicated that they provide conferences to the public about the most relevant trade issues, but many individuals interviewed feel that not enough is being done and have emphasized the need to streamline and further coordinate all of these efforts. Interviewees indicated that the chambers are not active in presenting bills to Congress, or in lobbying for reform. However, apparently the workers are very well organized and have organized marches to protest against the trade agreements signed by the country (such as against CAFTA). Through interviews, the team was informed that of the 67 members of the Legislative Assembly, the unions have secured 17 votes to oppose CAFTA.

Other institutions supporting international trade exist at varying levels of effectiveness. There are a large number of freight forwarders and Customs brokers. Financial institutions provide commercial credit at interest rates between 20 and 30 percent. The local media regularly reports on the most recent developments of the country and the region concerning trade.

Costa Rican businesses would benefit greatly from a coordinated effort by the professional associations and chambers to promote international trade law reform and institutional strengthening. The country would also benefit from specialized courses and seminars in matters pertaining to customs, trade capacity building, and the implementation of the provisions of the free trade agreements and their impact on Costa Rica's businesses.

E. SOCIAL DYNAMICS

The private sector ineffectively advocates for the enactment of modernized laws. This could be the result of the general view, in the private and public sectors, that Costa Rica's problems in international trade do not stem from the laws, but from their application by the relevant institutions. Interviewees said that most of the legislative changes produced in Costa Rica are the result of pressure from the United States (as was the case with the changes to the banking laws to reduce money laundering) or from international donor agencies.

One of the most significant legislative changes in the area of international trade occurred last year with the adaptation of the General Customs Law to CAUCA III. However, according to one interviewee, Congress has enacted very few (about five) useful laws in the past 3 years. Congress is currently focusing on CAFTA and the restructuring of the tax system, and there is no evidence of there being any political will to promote new and modern laws in international trade. Also, there is no high-ranking official pushing for international trade law reforms.

The business and professional communities rarely present bills to Congress, and when given the chance to comment on proposed legislation, they have often passed up the opportunity by either neglecting to comment or failing to conduct a thorough analysis of the effects of proposed rules.

Overall, in Costa Rica changes in the laws governing international trade seem to respond to international pressure, whether exerted directly by countries interested in trading with Costa Rica, or by the requirements of the free trade agreements signed by Costa Rica. The lack of organized effort from domestic businesses to change and modernize Costa Rica's international trade system has left a wide area for reform that is not being addressed on any front. In effect, some areas in need of modernization and reform that directly affect domestic business are largely left unattended.

F. RECOMMENDATIONS

- ♦ It is necessary to encourage regional solutions to problems in the trade facilitation, investment, and customs area. Technical assistance should be provided to establish a regional customs school, and to promote regional dispute resolution systems, among others.
- ♦ An efficient, well-staffed, trained, honest, and transparent Customs Service is absolutely essential for free trade. Problems in Customs including lack of training, insufficient of funds, corruption, lack of infrastructure, and lack of risk analysis systems and targeting methodology need to be addressed. Improvements in this area should help to expedite the clearance process, reduce opportunities for corruption, help deter smuggling, help stop drug trafficking and terrorism, and generally promote a healthy trading environment. This is essential to the implementation of CAFTA. There can be no free trade if goods are

stopped at the borders for hours, if they cannot be stored properly, if there is no security of cargo, etc.

- ♦ A strong, efficient, and functioning judicial review system of customs decisions (for example regarding the classification or valuation of merchandise, or whether it meets the CAFTA rules of origin) needs to be developed. This may discourage corruption among Customs Service officials.
- ♦ Costa Rica needs to enact and enforce civil and criminal penalties for violation of Customs laws that will truly deter unlawful activities, including corrupt practices, smuggling, importation of counterfeit or pirated goods, and drug trafficking.

XI. FLOW OF GOODS AND SERVICES

A. INTRODUCTION

The overall legal framework pertaining to the flow of goods and services is in place. For the most part, the laws that govern the institutions concerned with and operations of the flow of goods and services provide adequate authority. Implementation of customs laws remains as the critical issue facing the flow of goods and services within Costa Rica. Targeted resources and training are necessary to update Costa Rica's customs service to achieve greater employee performance in handling the current flow of goods, as well as the increases resulting from CAFTA.

B. LEGAL FRAMEWORK

The overall legal framework for current Costa Rican Customs law was enacted in 1995 and modified in 2003. It is very broad and provides Customs with a good framework for conducting Customs business. This Customs law is said to be the most developed in Central America, and a great deal of the language is included in the Central American Customs code. There may be need to further modify the law to incorporate CAFTA requirements. These issues are currently being studied.

Although the law, particularly as modified in 2003, is broad and promotes a modern Customs Service, many provisions have yet to be implemented. The law permits receipt of electronic declarations with electronic supporting documents, but the current automated Customs system is not developed enough to support a full electronic process.

The law provides for 24/7 coverage but only for the San José airport which currently operates on a 24-hour schedule and even there the procedural coverage is limited to manifest and export document presentation.

The law requires that professional-level Customs officers have a baccalaureate degree in the field of international trade. Some of the current staff was hired prior to this law and lack higher education.

Customs personnel are hired through a competitive procedure as identified in the laws of the National Civil Service. They are subject to codes of conduct covered by the National Civil Service, the Ministry of Finance, and Customs. Under national law, no Customs officer can collect monies directly from the public. Only the Director General is a political appointee.

The Customs law clearly defines the duties of managers and Customs officers and delineates parameters of authority with respect to other government agencies. Customs officers do not perform duties subject to other agency requirements. Candidates for employment with Customs must undergo a background investigation. Once hired, financial reviews are performed annually on Customs officers. Because these reviews do not include family members, their value in uprooting corruption is questionable.

Customs conforms to the Harmonized classification of commodities system, though Costa Rica is not a signatory to the Harmonized Convention. Kyoto Convention Guidelines on the

Simplification of Customs Procedures are considered and taken into account when guidelines are written, but Costa Rica is not a signatory of the Kyoto convention. The GATT Valuation Agreement on the Implementation of Article VII was implemented in 2000. Costa Rica is a member of the World Customs Organization (WCO), and became a member of the WTO in 1995.

The concept of self-determination for importer declaration has been incorporated into Costa Rican law, allowing the importer or the importer's broker to personally prepare the declaration. Customs law requires the agency to initiate an investigation within 4 years of declaration; however, this will soon be extended to 6 years.

Customs law requires the use of Customs brokers for all commercial importations. Since 1996, Customs brokers must have a baccalaureate and an additional year above the baccalaureate degree in Customs administration, but there are still many brokers who were working prior to the enactment of the law that have no higher education. In addition, other professionals may enter the field by passing a written test prepared and administered by Customs. According to interviewees, penalties for misconduct are specified in the law and range from \$100 to a 1-year suspension.

Penalties are clearly defined within the law for Customs violations and segregated into administrative and criminal actions. If the loss of revenue is \$5,000 or more, or the cost of smuggled goods is \$5,000 or more, the violation must be referred to the judicial authorities for criminal action. Courts have limited technical capacity to understand the complexities of Customs violations and thus provide practically no feedback from the judicial authorities justifying the outcome of the case. Appeal processes are in place to challenge Customs' decisions on administrative penalties within the agency and ultimately appeals go to the National Customs Tribunal that is not part of the judiciary.

Customs personnel have the authority to issue technical determination regarding valuation and classification. To be binding, these determinations must be signed by the Director General. Origin rulings are also signed by the Director General. Currently these rulings are specific to the party of interest and are not published or available to the public.

Risk assessment and selective examination of merchandise is covered within the law, and there is a current system that provides for parameters indicating level of examination incorporated into the electronic declaration system.

Customs has jurisdiction over the goods while in Customs custody, but once released, the goods are under the jurisdiction of the Fiscal Police, which is a separate entity under the Ministry of Finance. They have the authority to stop the goods once released from Customs. Customs has no undercover or arrest authority and must summon Fiscal Police. Customs can act only with judicial approval to intervene after release.

Costa Rica is not a signatory to the International Maritime Agreement and can board vessels only with the Captain's permission unless there is cause to believe the vessel is moving dangerous goods.

The laws on intellectual property are relatively new, and interviewees stated that there is little experience regarding their enforcement within Customs. The Ministry of Foreign Trade administers them and the Department of Justice has prosecutorial authority in intellectual property rights (IPR) violations. Customs has authority to detain when the Department of Justice issues a detention order based on an owner's complaint. Customs can detain a shipment when they suspect a violation has occurred, but the law is restrictive because a Customs officer can be held personally liable for damages resulting from an invalid detention.

Customs has taken action to promote a more efficient process and amended the law to modernize the process, but the constraints of a poor infrastructure, i.e., inadequate staffing, budget constraints, and organizational problems, impede the Customs process. Customs lacks the resources and knowledge base to adequately equip and train staff in modern customs techniques.

C. IMPLEMENTING INSTITUTION

The Economic Planning Ministry has developed a strategic plan to increase competitiveness within the Costa Rican marketplace. One critical element in this approach is the Customs competitiveness program, which involves the reorganization of Customs to promote both efficiency and the free movement of goods. Customs' 5-year plan includes these objectives. Customs has already begun implementing steps toward reaching these objectives. The Customs Service has initiated a reorganization to better meet the demands of modern commerce. Customs has identified the requirements for full integration in the Central American Customs Union. However, questions of national sovereignty, allocations of collected revenues, and lack of political will have delayed Costa Rica's participation in this effort.

According to interviewed sources, the current Customs budget hampers the agency's ability to modernize or maintain a well-trained staff to effectively carry out its daily functions. Customs recently conducted a study to demonstrate the return on investment to the government of increased staffing of 50 technical positions. The results were a 400 percent return on the investment within 4 years. Despite this, in 2004, the agency requested 9 billion *Colones* and received only 4.18 billion. Of this amount, 96 percent was absorbed by payment of salaries of its 700 employees, leaving nothing for upgrades in facilities, training, equipment, or IT improvements. Since customs has been under-funded for years, the tools used by customs, including IT equipment continue to deteriorate, and improvements cannot be undertaken.

Salaries for Customs officers are low, averaging at about \$1,000 to \$1,200 for managers and \$400 for technical positions, as reported by knowledgeable sources. This is said to be about 12 percent less than that paid to comparable positions in the public tax office and 80 percent lower than some other public positions performing similar work. Customs uses the National Civil Service generic performance standards for evaluation of employees on a yearly basis. These are ineffective in recognizing or rewarding outstanding performance or in identifying unacceptable work. No incentive or bonus program exists to recognize and reward good performance.

The Customs employment policy requires staff rotation. However, there are staffing inequities among the Customs field locations resulting in wide discrepancies in release times among posts. Sixty Customs officers are assigned to Puerto Limón, including both technical and administrative personnel, while 120 officers are assigned to the airport. Yet 80 percent of international trade

transits through Limón. To demonstrate the impact of staffing inequalities, import cargo at the northern land border post of Peñas Blancas is usually released within one hour after presentation of the documents to Customs while the standard for Limón is two days.

Customs has no training facilities or a cadre of capable instructors to conduct training. Training needs are identified through a yearly employee survey. The training staff then works with international donors to meet those needs. The French Embassy has been particularly helpful in providing such assistance. However, the donor must be willing to pay all costs associated with the seminar because Customs has no funds to pay lodging, per diem, etc., for the students or to provide the facilities.

On the most recent survey of the trade community, the Ministry of Finance and within it the Customs Service was singled out as the second most corrupt public agency, immediately behind the *Ministerio de Obras Públicas y Transportes* (MOPT). Customs has taken some measures to remedy this perception, such as creating a separate division within its legal department to handle corruption allegations and trying to solicit the trade's cooperation in reporting problems. These measures have not been entirely successful because the trade still hesitates to come forward for fear of retribution. Customs is counting on the implementation of more simplified and automated procedures to limit the opportunities for officer misconduct.

Comments provided by Customs personnel suggests that morale among the Customs officers is low. Low pay, poor working conditions, and lack of the required training and incentives for good work all contribute to this low morale. Customs officials feel no one is addressing these issues within the government. Contributing to the discontent is the awareness of very different conditions for Customs in neighboring Nicaragua. Because two percent of all Customs collections are returned to the agency for improvements there, salaries and working conditions are far superior to those in Costa Rica.

Despite these issues of budget, perception, and training, Customs is considered the most responsive government agency among the trade. Penalties for minor infractions are decreasing, and the agency is more responsive to the concerns of the trade. In many respects, Customs drives the modernization effort throughout the international trade sector through the development and mandated use of its automated operating system. As the principal agency regulating the flow of goods at the borders, it has the major responsibility for applying trade agreements. Customs is under intense national and international pressure to modernize and provide efficient, transparent, and responsive procedures to promote free movement of goods.

The current automated system is obsolete. Data validation and goods declaration processing may be conducted electronically, but the electronic goods declaration is not considered to be the legal document, although the law allows for this. Paper documents and associated other agency releases must be presented to gain release. Data is practically never shared, and there is no central database to enable Customs officials or other agencies to apply procedures in a uniform manner.

The risk system is very rudimentary with parameters and filters based on intelligence, risk, and review of documented violations. It does not address issues of compliance. There is no input of findings into the automated system and no importer history online for review. Officers can

change a system-generated release to an examination with the consent of the manager but cannot change an examination requirement to release goods without examination.

A new IT system, TICA, is to be available in the latter part of 2004. Its aim is to increase transparency and provide more information to its users. This system is Internet-based and the design modeled on the Uruguay Customs Automated System. Customs has received outside funding for building the system but there is still need for additional assistance. This system will integrate other government agencies, carriers, brokers, warehouses, and other entities into a full electronic process. It will allow for electronic processing including transmission of documents and storage of images, but there will need to be buy-in by the other agencies and issues such as equipment and communications must be addressed. The Inter-American Development Bank has provided funding for a software package for express consignment shipments, which will need to be integrated into the new IT system. Because the current Customs budget has no funds for IT development or equipment, attempts are being made to fund the continuation of this effort through a hybrid loan for the national competitiveness project sponsored by the International Development Bank.

Customs mandates that the declaration be transmitted electronically but paper documents must still be presented to gain release of goods. Customs has instituted an efficient single-window processing where all documents are presented for review after the required electronic transmission of the declaration, payment to bank, and authorization of release by other agencies. After review and acceptance, the goods can move immediately or documents can be further checked, which may take several minutes, or if an exam is required, the goods are generally examined within an hour or two.

Customs views its primary role as revenue producing and employs excessive and unnecessary documentation and examination requirements to perform this function. This excessive documentation delays release and results in an unnecessary burden on the trade community. These include requirements for the importer's certification of invoice information and statement of relationship to the exporter on every import transaction.

Excessive documentation requirements require customs officials to ensure documentary compliance, drawing them away from more substantive tasks. Presently, officers rotating through the audit or revision teams who review transactions after release of the cargo uncover the majority of incorrect declarations in the field.

There is no commodity specialization of Customs functions in the field. The Customs professional officers perform the full range of technical reviews, serving as the decision-makers in matters involving classification, value, and rules of origin; examination; and restricted merchandise. Maintaining expertise in all these constantly changing fields is difficult. A competent level of knowledge in all these fields cannot be maintained. The result is generalists who, however well intentioned, impair Customs' ability to collect the appropriate revenue.

According to persons knowledgeable of customs operations, examination rates are high at around 15 to 20 percent, with few discrepancies. When Customs detects an overage, the importer must get a written statement from the exporter, certified by the Costa Rican Consulate, to resolve the issue.

Customs officers do not wear uniforms but do have ID cards. There is a need to uplift the image of the officer and promote pride in service and self-esteem.

Release of commodities requiring other agency involvement is inefficient. Each agency performs its functions independently, sequentially, and without coordination or electronic interface with each other. Multiple agency examinations make the process cumbersome, resulting in delays in release. TICA, Customs new integrated processing system, will improve this situation only if the other agencies participate, and joint efforts are made to redesign examination and release procedures into a single process.

The export process is generally viewed by all as efficient. There is little intervention on the part of Customs regarding exports. Customs does not mandate that export data be entered electronically and very few exports are examined. Improvement to trade facilitation on exports will be initiated on June 1, 2004, between Costa Rica and Nicaragua. Both Customs administrations will share their export declaration data electronically on goods destined for each other's countries and eliminate all export document checks at the land border on such merchandise.

Goods are classified under the Harmonized System, and the WTO valuation agreement was implemented in 2000. Trade data is collected from the declaration and provided to the Central Bank that is responsible for administering trade statistics.

A Headquarters Enforcement Unit performs investigations based on complaints or the outcome of reviews and verifications including potential quota violations. They are also tasked with monitoring internal controls, identifying audit candidates, performing post audit, and identifying risk parameters. A staff of 40 is assigned to this unit. Enforcement personnel are precluded from performing undercover operations. There is some cooperation between government agencies, and the Unit also receives and analyzes intelligence on commercial fraud and Customs infractions.

No special enforcement planning is done at the post to identify its high-risk shipments and devise a strategy to address them, despite the significant difference in commodity and importer mix among locations and the knowledge of the local trading community at these location. No Customs special enforcement teams exist to create such threat assessments or to initiate short-term, continually changing intervention actions to maintain unpredictability of Customs actions and use that knowledge base. The result is the continuous selection of a static group of targets selected at the headquarters level that are readily known to the trade and easily circumvented. There is also no buy-in by local Customs in these actions.

The headquarters audit team consists of a staff of six who annually audit approximately 25 companies consisting mostly of importers but sometimes include brokers and other auxiliary entities. The background of personnel assigned to this group is in accounting, and they are trained in-house on Customs law and procedures.

Customs is in the process of understanding and implementing its role in the control of strategic goods. Costa Rica is party to all the international agreements regarding licensing and control of weapons of mass destruction (WMD) material and dual-use goods. The U.S. Embassy is working with Customs to provide training in antiterrorism and identification of WMD material.

The Ministry of Foreign Trade and judicial authorities administer the IPRs. Based on a complaint, judicial authorities mandate that Customs detain shipments believed to be in violation or Customs can detain shipments based on suspicion, but Customs has been reluctant to detain goods without judicial authority because of restrictive law holding the Customs officer personally responsible for an erroneous detention. The IPR laws are relatively new and there has been limited experience in applying them.

Control of access to the Customs area at the major border crossing to Nicaragua is inadequate. Unauthorized people are allowed access to the post and interfere and interrupt processing, including roaming in the area where merchandise is unloaded for examination, which is out in the open. Pilferage is a major problem in this environment.

Technical rulings can be issued at the local or headquarters level, but only rulings signed by the Director General are binding. Customs has a website where the laws and regulations can be reviewed and downloaded, but rulings and procedural circulars are not published. As mentioned previously, the trade community provided a software facility referred to as BUDHA, which is available through the website. The community has identified and made available procedural circulars for review by Customs and trade community, but rulings are specific to the party in interest and not published.

Customs has not developed an effective partnership with the trade community. Although Customs competently addresses individual problems, it does not see the trade community as a member of its team in either the development of procedures or policy. No system is in place to regularly meet with representatives of the different trading sectors to address common issues, solicit their advice, and exchange information. Customs has not fostered the trade as an ally in its need to facilitate legitimate trade and prevent smuggling and evasions of lawful requirements. Although the agency is beginning to recognize the benefits of such a dialogue, it still views this sector with suspicion.

Communication with the other border agencies is generally conducted through formalized inter-ministerial meetings chaired by PROCOMER of the Ministry of Commerce.

D. SUPPORTING INSTITUTIONS

1. Public Institutions

The trade community generally views Customs as the agency presenting the fewest problems with regard to nontariff barriers to trade. Although there is a strong perception of corruption among officers of the agency, the continually escalating requirements and lack of uniformity and predictability among the other governmental agencies presents many more problems to the trade community. In addition, there is some recognition of the efforts Customs is making to simplify its procedures, respond to trade concerns, and implement an integrated electronic system to coordinate all procedural requirements.

Processed and unprocessed food imports, including health products, are one of the most regulated sectors within the Costa Rican economy. Importers must comply with about 125 legal requirements, spread over multiple ministries. One of the most onerous requirements was

promulgated in March 2003 requiring all food products to be registered with the Ministry of Health before they can be imported. Those responsible for implementation are not fully trained in the requirements, resulting in lack of uniformity and consistency as well as delays in the application and approval process.

To secure this registration, valid for 5 years, each imported product must have two certifications, one from the exporter's quality assurance department that the item meets Costa Rican requirements, and the other issued by the food safety agency in the exporting country that the product is available for sale in the country of origin. The Costa Rican consulate in the country of exportation must notarize the statement.

This documentation is difficult to secure because many of the exporters do not understand the requirements. As a result, compliance leads to extensive delays in shipment. In some cases, exporters, particularly those shipping to SME's, elect not to do business in Costa Rica because of the additional costs and time required. Although the industry has stated its concerns and amending legislation has been prepared, the law has not been changed.

The Ministry of Agriculture and Livestock is divided into two major departments, Animal Health and Plant Health. Each has its own inspectors at the posts but share quarantine area. Both divisions need to modernize their laboratories, including equipment and staff training. Plant Health is better funded and has a more modern automated system to control and record its activities because its fees are dedicated to the funding of that department. That is not true of Animal Health.

The Ministry of Plant and Animal Health is in a state of transition, trying to balance free trade imperatives with protection of the farmers and the general public. Costa Rica's political climate keeps the agency from coming to terms with this issue. One arm of the government continues to advocate and press for simplification and elimination of trade barriers while well-entrenched domestic sectors promote legislation to prevent competition in the marketplace. The regulation regarding the importation of onions is one area where this dichotomy is clearly visible.

The law regulating animal health was adopted in 1978, while that for plant health dates from 1997. Required changes in both laws have been identified, with the amendments to the animal health regulations now at the legislature for consideration. In addition, both divisions are undergoing a review of operations to streamline procedures to promote optimal use of its limited resources and minimize procedural requirements for the users. In some cases this has been done in consultation with the trade community.

The trade community is also concerned with the recent implementation of a 1993 law administered by the Ministry of Agriculture and Livestock. This requires yearly reviews of the food processing facilities of exporters by the Costa Rican agricultural inspectors. The Ministry of Agriculture sets the schedule, and the suppliers must be available on their demand. The related costs, which can be significant, are borne by the importer.

Poor conditions exist for the examination and control of food products into Costa Rica by the food safety inspectors. Examination and sampling are usually performed in the open at the border posts, without adequate lighting, refrigerated facilities, or proper security. Space

restrictions on the off-loading dock restrict the inspector from going deeply into the conveyance to make his determination or extract his sample.

Inadequate staffing is an issue in the San José area. The airport is now the only location where inspectors review and approve agriculture imports in the area. Although this has been addressed by the trade as a major concern and adds delays in release, no corrective action has been taken.

The Department of Agriculture and Livestock has an electronic interface with the posts, but the posts cannot communicate electronically with each other or interface with any other agencies such as Customs. All food, whether processed or in a natural stage, is examined with no sort employed to separate food from firms with a history of compliance. Processing takes about two hours to complete at the land border, and up to two days at the marine ports. Multiple fees are collected for service. According to persons interviewed who are knowledgeable of the situation, the taking of bribes to expedite release is common.

Interaction between representatives of the border agencies is done informally at the posts as required. This is infrequent because each agency acts independently in its examination and document review functions, with Customs only accepting documents when all other agency requirements have been met.

The National Narcotics Police's focus is on narcotics interdiction in export cargo. Resources are sufficient. When additional staff is needed for an operation, the agency calls on the Civil Police or the Customs Fiscal Police for assistance. Reviewed facilities were excellent, with cells for detainment of smugglers, and fully equipped office and examination facilities, paid for with U.S. funds.

Although intelligence information from both national and international sources is passed from headquarters to the local posts, most onsite work is performed by instinct and intuition. No automated risk analysis systems exist to assist with targeting. At Peñas Blancas, officers walk the line of trucks cleared by Costa Rican Customs but awaiting entrance into Nicaragua to detect suspicious behavior or cargo. Approximately 10 are pulled aside each day for examination. Results since January 2004 include discovery of 300 kilos of cocaine and 22 kilos of heroin. No communication link has been made with the trade community, such as the brokers, to solicit their cooperation in identifying suspicious transactions or persons.

Costa Rica has two major ports, administered by separate national Atlantic and Pacific Port Authorities, both of which are under the MOPT. The Pacific port, Puerto Limón, handles about 80 percent of marine cargo for the country while Puerto Caldera on the Atlantic accounts for less than 20 percent, as stated by interviewees. Neither port authority has an automated system to receive manifest data generated from the generally state-of-the-art IT systems used by the major vessel carriers calling at the port. As a result, paper manifests must be submitted.

Limón has some of the highest operating costs in Central America. Of its revenues, 80 to 90 percent are allocated to labor that is organized into powerful and influential unions. Labor issues such as size of crews and work stoppages impair efficiency and drive up costs. This, coupled with poor infrastructure, is causing Nicaraguan companies to use other Central American ports even though Limón is closer.

Limitations on space within both ports require users to set up terminals off-site for the storage and inspection of cargo required by Customs or other agencies. If clearance is elected at the port and an examination is required by any agency, the cargo must be drayed to a terminal outside the port limits. This movement must be done under a surety bond supplied by the transporter and documents must be filed with Customs, all of which represent added costs to the client and delays. Cargo nationalized at Limón takes about 24 to 48 hours to release while cargo shipped in transit to San José for clearance arrives inland within 2 days of discharge.

Moín is a smaller port adjacent to Limón used principally by the major fruit companies and for break-bulk cargo. Although it is administered under the same port authority as Limón, the port has no equipment there. As a result, the shipping lines use the vessel's loading and unloading cranes. Since the carriers at Limón must use the port's equipment and are charged for that service, there can be significant differences in the operating costs to the carriers between these two locations.

There is little cooperation and communication between Customs and the port authority and no recognition that they should be partners in the facilitation and security of cargo.

2. Private Institutions

Most of the marine carriers are major international lines that are fully automated, knowledgeable about their responsibilities, and comply with industry standards for security. Cargo security is generally adequate for cargo arriving or departing by air or vessel. Because of space limitations at the ports, the major vessel carriers have established terminals outside the port limits where the majority of their containerized cargo is drayed immediately upon discharge. Several of the shippers also control movement of the container to the importer's premises. These firms are vigilant in implementing the international security requirements for storage and movement of cargo because they directly bear the consequences for missing cargo.

The association for vessel carriers and agents, Cámara Nacional de Armadores y Agentes de Vapores, represents most of the carriers calling in Costa Rica except some of the smaller break-bulk operators. The association is active in trying to influence legislation and regulations at every level and is presently assisting the MOPT with implementation of the international port security standards (ISPS) that must be in place this summer to ship to the United States.

Importers generally use the Costa Rican Chamber of Commerce to address common issues and influence legislation. However, the proliferation of chambers that the trade community can use to address its issues is extensive and therefore tends to dilute each one's effectiveness. Industry input into the legislative process is generally not solicited resulting in requirements that do not conform to international trading practices. Recently the legislature passed new requirements related to the filing of a certified Shippers Export Declaration along with each importation. Major trading partners like China do not use such documents for export and U.S. exporters are unwilling to share them with their clients for reasons of confidentiality.

Firms in like sectors communicate regularly with each other and unite informally to address common issues when warranted, usually after implementation of the requirement. When issues spread across the industry that require a coordinated approach, industry members collectively use

the services of the Costa Rican Chamber of Commerce to address their problems with either the appropriate ministries or in some cases directly with the Ministry of Trade. This was the case recently with major importers of processed and unprocessed food products, one of the most heavily regulated importing sectors.

In addition, importers are concerned with Customs' limited technical capacity to enforce all of the various rules that apply to the current free trade agreements. During interviews, it was noted that only about five percent of goods are covered by the current free trade agreements and the Central American Customs Agreement covers another 15 percent. It is estimated that CAFTA will cover a higher percentage of imports. Customs will need assistance to improve technical capacity in the area of application of rules and standardization of procedures.

There are multiple fees for services among the government agencies, which add significant costs to each transaction such as charges for certifications, stamps, examination, testing, and forms. For example, a \$3 fee is collected by PROCOMER for each import and export form that is only available through PROCOMER. The firms participating in the test run of Customs' new automated system, TIC@, are also concerned about the additional costs such a system will demand.

The export process is viewed as efficient and there were no specific issues associated with exports. Exporters are also importers of materials and capital goods and concerns were voiced by exporters in the area of imports. The exporters feel that the current scheduled work hours are not sufficient to cover their business needs.

Comments regarding the newly appointed Director General were positive assuming she would have the political support to modernize the current Customs operation. Customs reform must be considered together with changes to port infrastructure and the transportation sector. Without improvement within those areas, Customs reform will provide limited results.

There are presently an adequate number of Customs brokers, about 400. Prior to 1996, brokers had to pass a written test prepared and administered by Customs to enter the profession. Now a degree in Customs Administration is the only requirement. Many believe that the test served a useful function, sorting out incompetent candidates. Because the degree is easily obtained from unaccredited sources, the overall competency of customs officials is perceived to be lower than before the test requirement was rescinded.

However, generally the trade considers the majority of brokers to render good service at a reasonable cost, with open competition among them. It is acknowledged that there are some brokers who will assist the trade in its attempts to avoid lawful payment of duties and taxes. Recently, Customs has been more effective in regulating this through stronger penalty action.

There is a long-standing association of Customs brokers that presents industry issues to the concerned public agencies. It is generally viewed as inflexible and confrontational in its approach and therefore ineffective. Most brokers prefer to address issues individually with the public agencies, particularly Customs, an approach that is generally satisfactory.

Free-zone operators also expressed concern about Customs coverage. The current work hours are insufficient to meet their business needs. The airport has 24-hour coverage for exports but goods cannot be exported from the zone after hours or on weekends. Also if goods arrive from the port after hours they must wait overnight before they can enter the zone. This is a major economic problem particularly since some zone clients operate shifts.

The current procedures are designed to cover a manufacturing operation and are cumbersome when a service provider wishes to gain zone status. In addition, basic free-zone procedures, such as moving capital goods out of the zone for repair, moving goods to the local market, or closing a zone operation, are extremely time-consuming.

The Textile Association represents 12 percent of exports, which includes a major sector involved in value-added work. Its clients need to have predictability and just-in-time inventory to stay competitive. It is very difficult in the current environment to predict when materials will be released from Customs and establish lead times. In the association's opinion, Customs is not very efficient or predictable and these areas need to be addressed. There is also a major concern on the part of textile companies about the technical capacity of Customs officials to properly verify certificates of origin because improper verification may lead to charges of trans-shipment. Currently even established customs procedures are applied differently at each site and by each officer. Customs officers need additional training in the uniform application of procedures and rules.

The association has good relations with top government officials and meets with ministerial and department officials to discuss these problems, and there is agreement that corrective action must be initiated. However, once these initiatives reach mid-level management, they often stall or are deemed not doable under the current laws.

E. SOCIAL DYNAMICS

Public institutions consider the information presented by the trade participants to be unreliable. The belief of the public agencies involved in regulating imports/exports is that the majority of importers/exporters are trying to circumvent the payment of legitimate duties and taxes and requirements. Because no integrated IT system exists for all the regulating public agencies to use to track performance of either a company or product, reliable traders with a history of compliance cannot be identified for expedited treatment.

Generally the view held by the trade is that the public institutions that administer trade requirements have little interest in trade facilitation, are unresponsive to trade community concerns, and operate inefficiently. Unnecessary and additional requirements under the guise of public safety continue to be promulgated at the initiative of Costa Rican firms who want to close the national market to competition, and the ministries readily and rigorously respond to ensure job security. Importers would prefer dealing with higher tariff rates rather than the unpredictability and complexity of the continual escalation of nontariff trade barriers. Poor pay, inadequate staff, and lack of training and incentives within the bureaucracy coupled with the existing influence of anti-free-trade advocates will make change from the inside difficult. Trade facilitation and a truly open market will occur only as the result of outside international pressure.

International assistance is striving to make a difference in this climate and is requiring results. The European Union has allocated funding for the advancement of Central American economic integration, much of which is supporting training programs for harmonization of customs systems and procedures.⁶⁶ The U.S. Government has been particularly active in upgrading the facilities and equipment and therefore effectiveness of the National Narcotics Police. USAID will sponsor seminars to create mechanisms for governmental institutions and the trade community to communicate and work collectively to address trade facilitation and security issues.

The National Council of Competitiveness was created in 2002. It involves the Ministries of Economy, Foreign Trade, Public Works and Transportation, Tourism, Insurance, Electricity, and Telecommunications, and includes private sector associations. The Council has set up working groups covering major themes such as telecommunications, insurance, infrastructure, and finance and works to promote simplification and transparency of regulations. Several bills have been submitted to Congress. One such bill involves the need for a cost-benefit analysis for government requirements. The Council also provided recommendations for changes to ministries and departments but implementation of such changes is voluntary and at the discretion of the supervisory authority.

The working groups together with private sector associations and chambers developed the recommendations or potential bills and then discussed those with interested private sector parties.

In the Customs area, the working groups have promoted new more efficient procedures in the free zone area and have provided some training. The training has been in two areas: client services regarding the impact of excessive regulations, and discussion of case studies on problems experienced by the private sector. They have engaged Customs officials in discussing specific problems and worked with them on proposals for solutions hoping that this process would create a spirit of cooperation and ownership of the new procedures on the part of Customs officials.

Currently they are involved in working with the Customs directorate on support for a project to establish a valuation system for imports.

The procedures simplification recommendations by this group are guided by the Ministry of Economy, Industry, and Commerce and are intended to promote competitiveness and increase investment in the economy. The focus is to create laws and regulations with a legitimate objective addressed through technical or scientific means and that conform to international standards including international treaties as well as WTO agreements and requirements. They require national/public consultations and are required to be published. There is intent to review and update all regulations, educate the public on those regulations, and establish priorities for review.

This group focuses on the need for simplified procedures and not the overall needs of the Customs Directorate, such as improving technical capacity and providing adequate tools to

⁶⁶ See http://europa.eu.int/comm/external_relations/news/ferrero/2005/ip05_19-01-05.htm.

perform the work. Customs reform is often discussed, and occasionally specific changes are made, but a general Customs modernization plan has not been implemented. The media coverage of Customs is not often complementary. The general consensus is that the regulations are too general and too open to interpretation by the official conducting the specific function. Administrative guidelines are often modified, generating unpredictability in this area. Changes occur without appropriate notification or consultation. Communication among the major commercial sites is poor, and information about change is not always conveyed to officials in a timely manner. Officials ignore the added costs that their procedural changes place on the private sector. Through their work, the committee has tried to raise the awareness level of Customs officials through seminars and other initiatives.

The intent is to promote a favorable business and investment climate to achieve economic progress. The committee promotes a dialogue between government and private sector parties particularly in the area of the negative impact of cumbersome and unproductive procedures on the overall economy of the nation. They also work to eliminate the discretionary application of procedures to reduce the potential for corruption.

F. RECOMMENDATIONS

- ♦ Costa Rica must look for alternative funding sources for the Customs Service, such as the legalization of reimbursable services or collection of user fees. If these are reasonable and result in the delivery of more efficient and predictable actions, the trade community has indicated a willingness to pay them.
- ♦ A library of training materials as well as facilities and equipment for training needs should be established under a coordinated effort by all the donor agencies providing Customs assistance.
- ♦ Customs officers require training on IPR laws, detection of IPR violations, and their authority to detain goods believed to be in violation.
- ♦ The Customs agency should foster the trade sector as an ally in its need to facilitate legitimate trade and prevent smuggling and evasions of lawful requirements.
- ♦ Cooperation and communication between Customs and the port authority, commensurate with recognition that they should be partners in the facilitation and security of cargo, must take place.
- ♦ The current hours of Customs services must be expanded to meet business needs, allowing for exports after regular business hours and on weekends.
- ♦ The Customs Service should invest more in its human resources to promote a better business climate. Inspectors need computer skills, English language skills, and training in uniform application of procedures. There is too much red tape and no performance indicators or benchmarks to improve performance or review the need for a specific procedure. Procedures should be streamlined, more resources and equipment provided to Customs, full electronic processing instituted, and trade facilitation viewed as important as enforcement. This type of investment would impact positively on the economic well-being of the country.

XII. FLOW OF PEOPLE

A. INTRODUCTION

This section reviews the efficiency and security of trade-related flows of people across borders. The primary focus of the section is on the ability for legitimate importers, exporters, and their related facilitators (i.e., attorneys, accountants, business development professionals) to move across borders with as few impediments and as much security as possible as they trade their goods and services. Also of great significance, however, is the vulnerability of free and open societies. This assessment seeks to identify the appropriate balance between free movement for traders and restrictions on terrorists.

As with the trade-related flows of money, in a well-functioning trading system, the movement of short-term visitors is often a minor administrative detail in the trading scheme. Yet in some countries with overly restrictive security policies, or legacy restrictions on people flows in communist countries, entry into a country creates logistical and financial obstacles for legitimate traders. On the other hand, security policies and procedures are necessary to prevent entry of persons for illegitimate purposes, such as terrorists and other criminals who pose a danger to society. Flows of people for illicit purposes, when increased, can lead to instability in the trading system as a whole.

Overall, the efficiency and security of people flows in Costa Rica is adequate. The system supports contemporary methods for processing business-related travel that facilitates entry and exit at low administrative burden and cost. Illegitimate people flows are an issue for Costa Rica, particularly because of its higher level of development. It is estimated that one million Nicaraguans are living in Costa Rica. Furthermore, Costa Rica is a transit country for illegal migration to the north.

B. LEGAL FRAMEWORK

In Costa Rica, the legal framework for people flows is generally sufficient. Laws and regulations require no undue burdens for those traveling on trade-related business. The law does not require a visa for visitors from the United States, or from other CAFTA signatories. The law requires no entrance or visa fee for those entering. The law includes an airport tax on departure, but the fee is nominal, US\$27. Nor does the law impose lengthy administrative requirements or documents. In fact, Costa Rica and other CACM countries use a standard form for entry. Laws and regulations regarding longer stays are more restrictive as in many countries.

There is a clause in the law that gives the Director of Immigration the right to grant exceptions. This seems to happen on a regular basis, especially for doctors and nurses who come to Costa Rica for humanitarian service. Also, exceptions are granted to some bilingual professors, and specialists in a variety of areas where no such specialist is available here. These exceptions, when granted, are time- or task-limited and nonrenewable. In the case of employees of transnational corporations, many are granted temporary residency (giving them working privileges), rather than work permits, for a period of two years.

C. IMPLEMENTING INSTITUTION

Overall, the major implementing institution, the Immigration Agency, has a clear mission and is adequately staffed, equipped, and funded. Agents are posted at border crossings and the airport and are trained and equipped with passport-reading technology. The exit fee is collected through a transparent process.

Costa Rica uses watch lists from the UN, United States, and other sources to monitor entry and exit of dangerous persons. Although Costa Rica is not a high-risk country for these persons, the system has yielded results, including a known terrorist from the Basque-separatist group ETA, who was identified, arrested, and deported to Spain.

D. SUPPORTING INSTITUTIONS

Infrastructure, as elaborated further in this report, facilitates the movement of people. Costa Rica operates two international airports. There are direct flights to San José from many cities in the region, and North and South America and Europe. Border crossings, however, create different experiences for travelers. In part because of the infrastructure, waits can be long and complicated. This is an area of focus for improvement of people flows.

E. SOCIAL DYNAMICS

Trade-related people flows are generally supported at all levels because Costa Rica is relatively open. People flows in the form of tourism are widely supported and encouraged at all levels—Executive Branch, legislature, private institutions, and the general public. This is supported in accounts in the media.

Illegal people flows, particularly the influx of Nicaraguans, remain broadly controversial, and there are advocates for addressing these flows at all levels of government and the general public.

F. RECOMMENDATIONS

The laws and institutions affecting the flow of people in Cost Rica meet the needs of commerce and trade for Costa Rica. No changes are necessary at this time.

XIII. FINANCIAL CRIMES

A. INTRODUCTION

The term “financial crimes” applies to a range of offenses that includes fraud and money laundering. Fraud has been and continues to be the fundamental crime related to commercial activities. It involves gaining a benefit through means of deception. Money laundering, on the other hand, is not a traditional crime. The term identifies a set of prohibitions and/or regulations created to track and seize the proceeds from other crimes, notably drug-trafficking. Although regulatory in nature and related to other crimes, “money-laundering” carries its own criminal penalties, as well as civil and criminal forfeiture remedies.

B. LEGAL FRAMEWORK

Costa Rica has statutes dealing with general fraud and more specific statutes related to particular financial transactions. Costa Rica uses criminal enforcement to deal with transactions in which the commercial law is inadequate. For example, because of the inadequacies in the registration of security interests, multiple pledges of the same collateral—even when the collateral is sufficient to cover all the pledges—apparently constitutes the criminal fraud. With registration, and therefore notice to third parties, multiple pledges would not involve the deception essential to fraud.

Although reforming commercial law through registration and notification could reduce the reliance on criminal law to deal with fraud, other regulations with criminal penalties may be necessary to avoid fraud related to stock sales. Costa Rican law requires registration as a bank broker but not as a stockbroker. According to law enforcement, stock and investment fraud against foreigners (both those living abroad and in Costa Rica) is widespread. The fact that Costa Ricans generally do not trust stock investments and do not invest in them may account for the lack of such laws. If citizens are not harmed, legislators are not likely to place a high priority on preventing or punishing a particular activity. There may also be a disincentive to regulate stocks sales that enrich the Costa Rican economy almost exclusively at the expense of foreigners.

Costa Rica enacted its first law addressing money laundering in 1998. The money-laundering provisions were part of a broader law related to drug enforcement. In the wake of the terrorist attacks on September 11, 2001, Costa Rica adopted new legislation to bring it into compliance with international standards for detecting money laundering by terrorists. The current law combining the original provisions and the 2001 amendments is published in a booklet entitled, *Ley sobre Estupefacientes, Sustancias Psicotrópicas, Drogas de Uso no Autorizado, Legitimación de Capitales y Actividades Conexas y su Reglamento*.

C. IMPLEMENTING INSTITUTIONS

Costa Rica’s implementing institutions for financial crimes include police and Prosecutors, but with some distinctive features. First, Costa Rica’s constitution places the Judicial Police and the prosecution within the Judicial Branch, which is unusual for a system allegedly grounded in separation of powers. Such enforcement functions are classic examples of executive power. In

addition to the Judicial Police, Costa Rica has a special drug police force. Both the Judicial Police and the Drug Police are separate from the relatively new Institute Against Drugs.

Fraud investigations and prosecutions are the responsibility of the Judicial Police and the Prosecutor's office. Remarkably, the Judicial Police has had a financial crimes unit for more than 30 years. The unit includes auditors and investigators. With respect to petty financial crimes, law enforcement considers itself to be successful. During the 1980s and 1990s, they secured a number of convictions of bank fraud. They have also obtained convictions of a few government officials on corruption charges. However, Costa Rica's law enforcement has been less effective when dealing with large-scale fraud. Many of the foreign "victims" of fraud are apparently Americans and Canadians engaged in tax avoidance and who, therefore, are uncooperative. Law enforcement officials emphasize need for more resources and laws to investigate and prosecute a growing amount of fraud. In their view, fraud is a more serious problem than money laundering.

The pursuit of money laundering involves a more complex relationship among several implementing institutions. The 1998 legislation, referenced above, has created a new structure for the investigation of drug trafficking, the Institute Against Drugs. The Institute combines three agencies that had been under the control of the President, agencies for enforcement, prevention, and drug-regulation. Although the Institute reports to the President, it is an independent body governed by a board of directors. The Institute has been operational for about 18 months.

The work of the Institute is not limited to drugs. It deals with serious crimes, meaning those carrying a punishment of four or more years in jail. Examples of serious crimes include drug trafficking, terrorism, gun smuggling, child smuggling, and corruption. The Institute consists of several units devoted to prevention, education, and administration of seized goods, intelligence, and money laundering, as well as the local "franchise" for EPIC, a Drug Enforcement Agency (DEA) operation based in El Paso, Texas. According to interviewees, of the 87 people employed by the Institute, the money-laundering unit has seven persons, though this number is expected to double.

The Institute is a policy-making and coordinating body. Thus, the money-laundering unit works with the Judicial Police and the Institute on Financial Institutions, among others. Its focus has been on money laundering of drug proceeds, although it has investigated other crimes such as fraud over the Internet and gun smuggling. It receives information from a variety of sources, including its Intelligence unit, the Superintendent of Financial Institutions, U.S. law enforcement, and international agencies.

Pursuant to the statutory framework, which is similar to that in the United States, banks report deposits over \$10,000 to the Office of the Superintendent of Financial Institutions. When that Office considers a report worthy of further investigation, it will pass the information to the money-laundering unit of the Institute as well as to the Judicial Police. The information could also come to the Institute and/or the Judicial Police from an international agency. At the Institute, a single analyst initially reviews the report. If the report is considered "hot," the other six analysts will also join in the investigation. Ultimately the Judicial Police will work the case in conjunction with the Prosecutor. Once it is determined that the financial transaction appears to involve criminal activity, the Judicial Police will seek a court order directed to obtaining financial records. These investigations are difficult because the targets of the investigation are

uncooperative and the investigative tools available to the Judicial Police are said to be limited, although wire-tapping for money laundering is a possibility. Since the creation of the Institute, only two cases have been completely investigated and no money-laundering prosecutions have occurred. While asset seizure is a separate remedy, the government bears the burden of proving the monies were derived from criminal activity. Judicial Police have not seized a sizable amount of drug-money in three years, and the last major seizure was judicially forfeited.

D. SUPPORTING INSTITUTIONS

In addition to the courts, which are discussed in a separate report, the Judicial Police and Prosecutor receive information from the offices of three superintendents: Pension Funds, Financial Institutions, and the Stock Exchange.

Border security is inadequate. Costa Rica has no military. Since the Sandinista war, the Costa Rican government has been concerned about cross-border movements from Nicaragua. The Institute's money-laundering unit focuses only on the Nicaraguan border in an attempt to interdict drug shipments and money laundering, because the cross-border traffic from Nicaragua apparently funnels through a single point, while the border with Panama is said to have 200 illegal crossing points. The money-laundering unit clearly recognizes a number of problems regarding border interdiction. As with the United States, the borders of Costa Rica are very porous.

E. SOCIAL DYNAMICS

Costa Rican law enforcement agencies see their longstanding financial crime units as a source of pride, though limited resources result in little real impact. Costa Rican law enforcement receives assistance from U.S. law enforcement and international agencies. However, technical assistance in financial crime enforcement is poorly coordinated among donors. Changes in Costa Rica's money-laundering statute in 2001 have been influenced considerably by U.S. law enforcement. If not adopted, Costa Rica would have suffered sanctions resulting from the status of being "noncompliant." However desirable the changes are, they are not reforms chosen in any meaningful way by the Costa Rican government. Given the new realities of post-September 11, 2001, the pressure to adopt these changes may not itself be a source of friction.

On the other hand, the failure of U.S. law enforcement to cooperate in communication and training has produced some resentment. From 2001 to date, it was reported that the Judicial Police has made approximately 400 referrals of suspicious financial transactions, each of \$700,000 or more, to federal agencies. From these, the Judicial Police has received only one response. It was also reported that the Judicial Police is often limited in its points of contact within the U.S. Government, hampering investigations. For example, the head of the Judicial Police reportedly can only contact FINCEN, which only supplies data. Other Costa Rican officials expressed optimism that the new arrival of a DEA officer at the U.S. Embassy will provide access to communication with U.S. law enforcement agencies. The communication between the money-laundering unit in the Institute Against Drugs and U.S. agencies should be better because of the direct links between the two agencies. The institute has good information exchange with FINCEN. Otherwise, however, that agency also indicates that it does not receive the assistance it needs from U.S. agencies to proceed with cases that should be prosecuted in

Costa Rica. The Institute echoes the complaint that communication is one-way; it supplies the U.S. agencies with information, but it does not receive responses to information requests. U.S. law enforcement agencies expect cooperation from their Costa Rican counterparts. Unless the relationship becomes reciprocal, however, U.S. agencies should not be surprised if Costa Rican law enforcement becomes less responsive.

In addition, the manner in which training is conducted is a point of cultural conflict. In Costa Rica, a sense of professional accomplishment and national distinctiveness are points of pride. General training that is not specific to the Costa Rican context would be perceived to be insufficient for their needs. Given their longstanding experience, many Costa Rican law enforcement officials feel that they should be considered the model for a Central America-wide training initiative. Given the legal-cultural differences between the mindset of those educated in an Anglo-American common law approach and that of those raised in a civil-law jurisdiction, harmonization and coordination between the United States and CAFTA countries presents different challenges than those among CAFTA countries.

F. RECOMMENDATIONS

- ♦ Costa Rica's 30-year experience with prosecuting financial crimes represents an opportunity for the other CAFTA countries to benefit from its lessons learned. Regional training programs sponsored or co-sponsored by the United States should consider incorporation of the Costa Rican experience, using Costa Rican instructors, into the training curriculum.
- ♦ To the extent that widespread fraud against foreigners is generally overlooked by the Judicial Police and Prosecutors, economic activity in Costa Rica will be hindered. Positive relations between foreign investors and local business associations might be encouraged through such informal means as regular roundtable discussions and other opportunities to learn about business norms, expectations, and risks in Costa Rica.

XIV. FLOW OF MONEY

A. INTRODUCTION

This section reviews the efficiency and security of trade-related flows of money across borders. The primary focus of the section is on the ability of importers and exporters to provide and receive payments with as few complications and with as much security as possible across borders as they trade their goods and services. (It is not the purpose of this diagnostic to encompass the macro financial issues of Costa Rica's account balance or trade balance.)

In well-functioning trading systems, the movement of payment is often a minor administrative detail in the trading scheme. Yet, in some countries, because of such issues as legal restraints on electronic payments and restrictive currency exchange policies, the mere payment for goods and services creates yet another obstacle for legitimate traders. On the security side of money flows, this assessment addresses illegitimate money flows that place stress on the system, such as money laundering, counterfeiting, and other financial crimes. These issues, when intensified, can lead to instability in the payment system and the trading environment as a whole.

Overall, the efficiency and security of trade-related money flows in Costa Rica is quite strong. The banking system offers contemporary methods for traders, and there is a well-developed market of banks that offer the appropriate banking and finance tools.

B. LEGAL FRAMEWORK

In Costa Rica, the legal framework regarding the efficiency and security financial flows is generally quite sufficient. The Trade Finance Guidelines by the International Chamber of Commerce are generally applicable. The laws conform to the Uniform Customs and Practice for Documentary Credits. The legal framework for trade-related finance allows for payment through wire transfers, foreign checks, commercial letters of credit, standby letters of credit, documentary collections, and open accounts. Importers and exporters do not find the legal framework to be overly cumbersome or complicated.

The legal framework for currency exchange also provides for suitable flexibility for traders. Costa Rica pegs its currency, colones, to a basket of currencies. This currency exchange rate is adjusted daily. Under the law, traders have the freedom to exchange currency at financial institutions and nonbank institutions alike, including hotels. In addition, products that allow traders to hedge finance risk are also legal. Laws addressing illegitimate financial flows are also in place.

C. IMPLEMENTING INSTITUTIONS

The Central Bank of Costa Rica manages exchange rate policy and regulation. As to exchange rate policy, the institution has sufficient capacity to administer this function. Regarding foreign exchange offerings, financial institutions (banks, currency exchanges) and others provide exchange. Although not a formally dollarized economy, the dollar is generally tradable in the market—accepted by merchants large and small in the exchange of goods and services. As noted above, the legal framework allows for derivatives instruments in currency (futures contracts for

hedging exchange risk). It was noted that, while available, few clients use currency hedging because of the stability of the colones.

The implementing institution involving bank regulation is the General Superintendence of Financial Entities (Superintendencia General de Instituciones Financieras—“SUGEF”).

There is a well-developed banking system that includes some 20 banks (three public and 17 private) most of which provide some form of trade financing. As was learned during the in-country assessment, virtually all banks offer letters of credit, but not all offer documentary collections and receivable financing. One institution offers a full range of service offerings that includes finance, and other trade services such as customs brokerage and bonded warehousing. These financial institutions offer trade finance to domestic importers and exporters on reasonable terms. Importers and exporters report that rates for these products are reasonable.

Costa Rica has a very advanced system of trade finance where open accounts are the normal method of payment for most medium-scale and all large-scale exporters and importers. Small-scale exporters and importers new to the international trade markets use letters of credit. Importers and exporters hold a largely positive impression of the efficiency and cost of trade finance and the currency exchange system.

Inter-regional barriers to trade are one particularly problematic area for CAFTA countries. Banking across borders with the same bank is nearly impossible. Each country has different rules and regulations. For example, a company based in Costa Rica with subsidiaries in Nicaragua and Honduras using a bank with offices in all three countries cannot use and exchange money within the same account. Separate accounts must exist for the Nicaraguan and Honduran subsidiaries, which are effectively separate banks. Respondents identified this issue as a major problem and concern, and expressed a high-level of interest in standardized banking codes across the region to release banking flows and capture trading efficiencies.

Financial institutions facilitate access to foreign credit information. The institutions inform their clients about credit insurance. Financial institutions also provide advice to exporters, in particular new exporters, for adequate use of credit insurance in light of the method of payment of the commercial transaction and potential risk. Staff is trained in laws governing financial exchange and overseas trade, and in facilitating overseas trading transactions.

The financial institutions advise clients on the preshipment financing facilities available in their country or region and provide access to export factoring services for their export clients. They are able to refer clients to qualified forfeiters and assist client importers in obtaining the requisite guarantees. They also are able to refer clients to qualified countertrade brokers and financial institutions specializing in countertrade facilitation. There is a computerized database for providers of financing, payment services, credit insurance, and credit information.

As noted, currency exchange can occur at numerous institutions, including banks, currency exchanges, and hotels. Currency exchange operates at rates that are highly competitive, and fees for wiring money abroad are less than 10 percent of the amount of money to be wired.

D. SUPPORTING INSTITUTIONS

Costa Rica has no government-sponsored export credit agency.

The Banker's Association, on the other hand, is viewed by some as an ineffective instrument for advocacy because of the banking structure in Costa Rica.

E. SOCIAL DYNAMICS

With a well-functioning system regarding the flows of money, there is little advocacy within public and private sector institutions for overall change. There is one dynamic important to CAFTA and regional integration; however, namely, traders find it difficult to finance regional businesses. While the bilateral exchange of funds for traded goods and services functions well, cross-border flows financing regional business activities face a significant regulatory hurdle. Companies with subsidiaries in neighboring countries are forced to set up banking accounts individually rather than using branch accounts. Recently, however, there is a growing presence of regional companies whose operations cross multiple borders. These companies are advocating for rules that facilitate this type of cross-border trade.

F. RECOMMENDATIONS

- ♦ Improve access to credit for small and medium-sized importers and exporters.
- ♦ Establish a guarantee fund offering credit to exporters for fewer guarantees than currently demanded.
- ♦ Develop associations between producers to create common pools of resources and risks to acquire lower cost credit.
- ♦ Conduct seminars and training to inform importers and exporters of existing bank instruments.

XV. SUPPORTING INFRASTRUCTURE

A. INTRODUCTION

This section addresses the efficiency and security of existing trade infrastructure within Costa Rica. Trade infrastructure includes supporting transportation infrastructure, such as roadways, airports, seaports, railroads, and border crossings. Additional infrastructure assessed includes electrical power generation and distribution, telecommunications, and IT. This assessment provides a snapshot of the nation's existing infrastructure across the following areas: inventory of facilities, serviceability and conditions, predominant operations, capacity, utilization, and capital planning initiatives.

Overall, Costa Rica's trade infrastructure suffers from systemic negligence in both maintenance and expansion. Infrastructure development has been outpaced by demand over the past decade. While not quantifiable, the costs associated with continued operations under existing conditions will hurt Costa Rica's competitive position in the marketplace. Costa Rica will require focused investments in infrastructure to facilitate trade. Of particular importance are overland transportation facilities (i.e., roads and rail). Along many stretches, roadways are substandard and inadequate to efficiently accommodate today's volume of traffic, and also in poor repair. The rail network is operational along only a fraction of existing rights-of-way, providing limited service for select private entities.

Costa Rica's primary seaport region on the Caribbean Coast, Limón/Moín is operating at above sustainable capacity. Existing berth occupancies are currently comparable to high-demand international seaport facilities. Private sector carriers have invested heavily in inland distribution terminals to correct for the seaport's lack of on-dock storage capacity. Consequently, operational costs associated with double handling, drayage, and the potential for significant delays are high and will ultimately price Costa Rica's seaport system out of the competitive market unless significant expansion of port facilities is implemented.

Costa Rica's international airport infrastructure is currently planned for significant private sector investment and is operating at serviceable levels. Air cargo is augmented by inland distribution facilities and is reported to have available capacity for cargo growth.

Costa Rica's electrical power distribution, telecommunications, and IT services are operating at serviceable levels with minimal reported outages. However, the services are currently provided through a government-owned monopoly agency.

B. LEGAL FRAMEWORK

The MOPT is responsible for planning, coordination and supervision, implementation, and maintenance of Costa Rica's transportation infrastructure. The MOPT consists of six councils each responsible for various segments of public transportation infrastructure: CONAVI—Highways, CTP—Public Transit, CETAC—Civil Aviation, COSEVI—Road Safety and Security, CNC—Concessions. The sixth council, The National Ports Council, provides coordination for capital planning and expenditures for the nation's seaport authorities.

The MOPT is responsible for setting all transportation development objectives through implementation of a National Plan, which is updated in cooperation with changes in national administration and approved by the Planning Ministry. The current plan outlines national projects through 2006. Although the potential exists for the National Plan to undergo significant modification following inauguration of the next administration, existing projects in the plan are described as well-defined national priorities and are unlikely to change. All public projects must be incorporated in the National Plan prior to execution; however, new projects may be included outside the update cycle as set forth by the MOPT. The National Plan is reviewed annually for budgeting purposes, which may result in reorganization of priorities and potential project delays. The National Comptroller ultimately approves all funding for project implementation.

Electrical, telecommunications, and IT services are provided by a national monopoly authority, ICE. Services are generally reliable. Consequently, little political will exists to de-monopolize and privatize these services as of this writing. Labor unions are an important issue with regard to this monopoly organization, having significant political clout.

The National Comptroller ultimately approves fiscal plans and funding for public projects. This tier of governmental control has the authority to allocate funds as deemed appropriate and has historically delayed necessary public improvement projects in favor of other priorities. The Comptroller is also charged with approval of public tariff structures making it difficult for implementing institutions to adjust rates for services provided to realize revenues required to undertake planned improvements.

C. IMPLEMENTING INSTITUTIONS

1. Roadway Networks

CONAVI is responsible for roadway improvement planning and implementation. The Council reports to the MOPT and is subject to the approval requirements of the National Plan development and the National Comptroller.

According to information gathered from MOPT, Costa Rica's roadway network encompasses approximately 36,000 kilometers of which approximately 7,900 kilometers are paved. Paved roads are provided along all principal routes between municipalities. Roads outside the cities are generally two lanes with one additional climbing lane in the mountainous regions as required. In general, the paved roadways are narrow, are designed with no shoulders, with the potential for steep grades and sharp horizontal and vertical curves. Along frequent stretches, paved roadways provide poor sight distances, are poorly marked, maintain variable design speeds, and are in poor repair. Traffic conditions can be very heavy with frequent blockages resulting from malfunctioning/abandoned vehicles and vehicles requiring frequent delivery stops. Estimated levels of service are below C during non-peak periods, and approach F during peak periods along arterials and collector roadways.⁶⁷

⁶⁷ Roadway Level of Service is a calculated value determined from the Highway Capacity Methodology. Level of Service is rated on a scale of A to F, Level of Service A being a condition of very low delay and Level of

An important initiative is the Plan Puebla-Panamá project, currently under way in cooperation with other Central American countries. Execution of this plan will contribute to regional economic growth through redevelopment of the Pan-American Highway. The project is being conducted in phases and will involve development of highway cross-sections consistent with the highest levels of international best practices.

2. Airports

CETAC is responsible for implementing Costa Rica's national and international airports through a subsidiary, the *Dirección General De Aviación Civil* (DGAC). Project funding is provided through revenues generated from tariffs; however, are subject to both the guidelines of the National Plan and the consent of the National Comptroller.

Juan Santamaría airport, Costa Rica's largest international airport, currently operates under a long-term concession contract with Alterra Partners, a London-based firm. The concession contract is with DGAC. The concessionaire's responsibilities are limited to airport operations only, excluding such items as air traffic control, customs, immigration, and security. The concessionaire is expected to invest \$180 million in improvements over the 20-year term of its contract; however, political issues surrounding tariff rate increases are preventing further investment as of this writing. The concessionaire reports to the DGAC under the MOPT and is subject to the financial approvals of the comptroller.

Juan Santamaría airport is equipped with a single class D-IV flexible pavement runway, includes a total of eight terminal gates, and is required to operate at Level C during peak periods, currently experienced during weekday mornings and evenings. According to Alterra Partners, approximately 95 daily air operations are currently accommodated at the facility. Passenger facilities are considered adequate should increased passenger handling be spread over existing nonpeak times. Air cargo facilities are provided for multiple carriers and are considered adequate because of predominant operations. Multiple off-airport private distribution terminals, providing minimal dwell times for air cargo, augment air cargo facilities. It is anticipated that further development of private sector terminals will continue to facilitate air cargo handling at Juan Santamaría airport.

Costa Rica's second largest airport, located at Liberia, is currently being upgraded to accommodate larger volumes of international traffic. The facility is fitted with an estimated Class C-III runway of flexible pavement construction. Two additional airports are currently classified as international airports but are in fact of limited capability to accommodate international traffic.

Remaining airports, encompassing a total of 29 public and 62 private aerodrome facilities, scattered throughout the country, may be considered small general aviation facilities of variable capabilities. Runway capabilities vary and may include flexible pavements, gravel pavements, or unpaved.

Service F being a condition of long delays. For this project, no calculations were prepared, however Level of Service was estimated for reference.

3. Seaports

Costa Rica's seaport facilities operate as independent port authorities, responding to a board of directors. The two largest port authorities are JAPDEVA, located on the Caribbean Coast, and INCOP, located on the Pacific Coast. Port authority responsibilities exclude Customs, Immigration, and Agricultural inspection services. Although autonomous in operations, capital projects are subject to the approval of the MOPT and coordinated through the National Harbor Council. Similar to all other MOPT activities, all seaport capital programs must be incorporated in the National Plan prior to execution and funding certified by the National Comptroller. The National Comptroller approves tariff structures.

Although Costa Rica has a total of six seaport facilities, three facilities represent the bulk of international cargo and passenger traffic handled. The primary facilities, Puerto Limón and Puerto Moín, located on the Caribbean Coast and governed by the JAPDEVA (*Junta Administradora Portuaria y de Desarrollo Económico de la Vertiente Atlántica*), handle approximately 80 percent of the country's cargo throughput. According to persons interviewed for the assessment, on the Pacific Coast, Puerto Caldera, governed by the INCOP (*Instituto Costarricense de Puertos del Pacífico*), handles the remaining 20 percent of the international cargo.

Puerto Limón is the primary container terminal, equipped with two 40-tonne gantry cranes on a quay. A single breakbulk/neobulk pier with two berths, and a dolphin/RoRo pier with two berths are provided for other cargo and passenger vessels. The facility handles containerized, breakbulk, and neobulk cargoes, as well as passenger traffic, and encompasses a total 20 Ha, with 7 Ha dedicated for container handling. The facility provides little to no onsite storage areas requiring private carriers to coordinate drayage to private inland terminals while vessels are worked. As indicated by interviews with knowledgeable officials, approximately 90 Ha of inland container storage space is provided by the private sector. Drayage costs and double handling costs are consequently significant components of the overall costs for cargo handling services.

Puerto Limón's infrastructure is augmented by nearby Puerto Moín, located approximately 6 kilometers toward the north. Puerto Moín is fitted with a 525-meter marginal quay used for both neobulk and container handling. The neobulk area is designed specifically to accommodate the needs of the Port's fresh fruit carriers, providing short-term wheeled container storage areas, container stripping stations, and associated mobile forklift equipment. The container facility encompasses 4 Ha and is of recent construction, having over 40 Ha future expansion capabilities. The facility has no fixed equipment, i.e., container gantry cranes, necessitating all cargo transfer performed using onboard ship's gear. The container facility is currently designed to accept future Panamax class gantry cranes on the quay.

Puerto Moín is the nation's gateway for all petroleum products. The facility, operated by RECOPE, provides berthing capacity for an approximate 40,000 DWT vessel and is planned for significant expansion. Petroleum products include both refined and crude.

Puerto Moín is planned as the future major freight handling facility on the Caribbean Coast. While still in the master planning stages, the key advantage of the proposed plan is future relocation of major truck traffic around the City of Limón. Currently, all traffic to and from

Puerto Limón must transit the main thoroughfare through the City of Limón, putting significant strains on the existing corridor, adding to delays, and increasing operational costs. Further development of Puerto Moín will also strategically place container traffic proximate to many of the existing inland terminals. However, the proposed plan, as of this writing, provides marginal increases in on-dock storage capacity maintaining current drayage operations as part of the long-term plan. Execution of the regional plan will maintain only passenger operations at Puerto Limón providing opportunities for commercial development projects for the tourist industry.

In general, both Puerto Limón and Puerto Moín are in good serviceable condition; however, they are currently operating at or near capacity providing little opportunity to accommodate significant increases in cargo. Current volumes exceed projections identified in the most recent master plan, dated 1995. In the long-term, significant facility expansion, landside access improvements, and deployment of modern equipment would be required to facilitate further trade. In addition, JAPDEVA's current labor structure should be evaluated. According to JAPDEVA, the current labor pool includes approximately 1,200 unionized employees, representing more than 70 percent of the organization's operating costs. The labor pool excludes stevedoring and trucking services, each provided by private operators.

Puerto Caldera provides access for waterborne cargo to the Pacific Ocean. The facility accommodates containerized, breakbulk, and neobulk cargoes. The facility necessitates employment of onboard ship's gear for all cargo movements. The facility has been the subject of a recent privatization initiative, which has stalled, and consequently not seen any significant upgrades for the past several years. Similar to JAPDEVA, INCOP's labor pool is significantly large and should be reevaluated as part of the privatization initiative.

4. Railways

Costa Rica's railway network encompasses approximately 960 kilometers with a primary corridor between Limón through San José to Caldera. However, only 260 kilometers of the nation's rail lines are in serviceable condition and are currently used along two routes for fresh fruit movements from plantations to private seaport terminal facilities along the Caribbean Coast and dry bulk movement along the Pacific Coast. To fully capture the benefits of rail transportation, the overall rail network would require extensive repairs and upgrades throughout the country. Principally, upgrades along the east-west routes to San José and both coasts have the potential to add significant benefits for the country's transportation system.

5. Border Crossings

Border crossings raise significant infrastructure issues for Costa Rica. The overall infrastructure of the facilities is inefficient and insecure. With facilities too small to handle the volume of trade, there is little or no security fencing, which leads to an overcrowded border.

6. Power Distribution

ICE, a state monopoly, is responsible for the majority of electrical power generation and all distribution. Approximately 20 percent of the country's electrical power generation is currently

provided by the private sector through co-generation agreements and build-operate-transfer (BOT) mechanisms.

Electrical power is generated principally via hydroelectric plants. Approximately 80 percent of the country's power is generated in this manner, with the remainder generated from fossil fuels and wind generation facilities. ICE generates approximately 1500 mega-watts, with an approximate additional 300 mega-watts provided by the private sector. Power consumption per capita is approximately 15 percent that of the United States. Power distribution is considered adequate throughout most of the country, with few long-term outages experienced during the course of a year. During peak loading conditions, isolated brownouts can occur. However, in general, power generation and distribution is considered both reliable and scalable.⁶⁸

7. Telecommunications and Internet

ICE also provides telecommunications and Internet services through wholly owned and licensed subsidiaries. Telecommunications includes both fixed lines and wireless services, and Internet services include both broadband and dialup services. Data from 2001 indicate ICE has more than 860,000 active fixed telecommunication lines with approximately 1.05 million installed capacity. Active wireless lines were approximately 500,000 for the same period. Telecommunications and Internet service are considered both reliable and scalable.⁶⁹

D. SUPPORTING INSTITUTIONS

1. Trucking Companies

Private trucking companies operate throughout the country with significant capacity provided at the seaport terminals. Trucking companies provide drayage and inland distribution services for all international trade. Most trucking companies provide bonded services to accommodate customs requirements for inland terminal inspections and to expedite removal of cargo from the seaport terminals. The quantity and quality of trucking companies available within Costa Rica is considered adequate and scalable to facilitate trade.

2. Airlines

Juan Santamaría airport is served by most major airlines currently providing service to accommodate over 2.2 million annual passengers. Major carriers also provide air cargo service. Air service is considered adequate and scalable to facilitate trade. Carrier service to other domestic airports is a minor segment of overall air transportation with available capacity to accommodate growth.

Other supporting institutions include Customs and Immigration. Juan Santamaría airport officials indicate that immigration-staffing levels are frequently inadequate to accommodate passenger volumes during peak periods.

⁶⁸ OECD, Inter American Development Bank – Caribbean Investment Initiative Report

⁶⁹ OECD, Inter American Development Bank – Caribbean Investment Initiative Report

3. Ocean Carriers

More than 24 carriers calling on regular intervals serve Costa Rica's seaports. Services include containerized cargo, breakbulk, neobulk, and liquid bulk cargoes. Private sector stevedoring companies provide vessel stevedoring. Private sector transportation companies provide landside transportation. Sufficient supporting institutions participate in the maritime activities of Costa Rica.

4. Railways

Railway service is currently provided for discrete customers serving the fresh fruit and dry bulk industries. Railway service is considered adequate to accommodate these discrete needs; however, significant infrastructure upgrades and corresponding rail service increases would be required to use the nation's rail network beyond current use.

5. Power Distribution

Power distribution from private sector generating plants encompasses approximately 20 percent of the overall power generated within Costa Rica.⁷⁰ While these institutions compete with ICE, the ICE maintains control of distribution. The presence of the private sector is considered to provide sufficient buffers for ICE within its monopoly. An increase in private sector involvement would provide Costa Rica with a competitive landscape from which cost-effective power generation initiatives may be implemented.

6. Telecommunications and Internet

Wireless telecommunications and Internet services are provided through contracts with subsidiaries of ICE. While ICE has the authority to expand the number of contracts it maintains, the number of service providers currently employed maintains a monopolistic environment.

E. SOCIAL DYNAMICS

Costa Rica's transportation infrastructure represents the central focus for improvements required to facilitate trade. The nation's road network will require significant upgrades along major arterials. Upgrades should consider widening of arterials to four-lane divided highways, with appropriate climbing lanes in mountainous regions. It is recommended that a detailed traffic analysis be conducted to prioritize road improvement projects and focus resources. The nation's rail network provides an opportunity to realize potential benefits of intermodal freight movement. A detailed analysis should be conducted to evaluate the feasibility of redeveloping Costa Rica's rail network and identify the potential cost savings and impacts to the environment. Costa Rica's major seaport infrastructure will require significant expansion and organizational changes to facilitate trade. The combination of seaport expansion and inland transportation improvements would help in reducing overall transportation costs to international freight and assist Costa Rica in maintaining its competitive position.

⁷⁰ OECD, Inter American Development Bank – Caribbean Investment Initiative Report.

F. RECOMMENDATIONS

- ♦ With respect to rail capacity, detailed corridor analyses should be conducted to evaluate future freight movements and focus capital resources on priority projects.
- ♦ To expedite implementation of infrastructure improvements, Costa Rica should consider the advantages of private sector investment through concessions, public-private partnerships, or other private sector involvement. Currently, public resources are scarce and projects are subject to delays because of financial pressures and variable prioritization resulting from changes in administration.
- ♦ Costa Rica's roadway network will require significant capital outlays to facilitate trade in the long term. Detailed traffic studies will be required and extensive planning with regard to major corridors and road capacity requirements should be undertaken. These analyses should identify priority projects to focus future capital expenditures required to facilitate trade.
- ♦ In the long term, significant facility expansion, landside access improvements, and deployment of modern equipment at Costa Rica's seaports will be required to facilitate further trade.

ATTACHMENT 1: COMPILATION OF RECOMMENDATIONS

COMPANY LAW

No.	Type	Recommendation	Priority	Duration
1.	Institutional Strengthening/ Strategy Development	Reform of the Commercial Registry to make it totally automated and improve the procedures, along with introduction of strategic planning methodology and management tools.	High	Long term
2.	Training/ Education Campaign	Corporate governance training for business people, lawyers, judges and governmental officials and promotional campaign on corporate governance for the society at large.	Medium	Long term
3.	Legal Reform	Legal reform in Commercial Law to incorporate world class corporate governance principles, protection to minority shareholders and exceptions when the legal personality of companies could be disregarded.	Medium	Long term
4.	Analysis/ Strategy Development	Diagnostic of the micro and small business situation and identification and removal of obstacle that affect the growth of that kind of business.	Medium	Long term

CONTRACTS

No.	Type	Recommendation	Priority	Duration
1.	Legal Reform	New laws for leasing, electronic contracts and guarantees, along with a new arbitration law and an oral civil procedure law.	High	Long term
2.	Legal education	Program on international business transactions, economic analysis of law, foreign legal doctrine and jurisprudence and electronic contract arrangements for lawyers, and customized for judges and arbitrators.	Medium	Long term
3.	Judicial reform	Reform of court system to introduce technology, managerial techniques and public automated access to court information.	Medium	Long term

REAL PROPERTY

No.	Type	Recommendation	Priority	Duration
1.	Consensus Building	Consensus building around expropriation-compensation, national registry reforms, professional standards for notaries and real estate brokers and squatters.	Medium	Long term
2.	Legal Reform	Legal reform to increase the standards of notaries and real estate brokers.	Medium	Medium term
3.	Institutional Strengthening/ Strategy Development	Zoning entities to be reshuffled, organized, strengthened and trained.	Medium	Long term
4.	Analysis	Analysis of how and where taxes imposed on real property are assessed and eventually transformed into mechanisms that foster business.	High	Medium term
5.	Implementation assistance – my suggestion instead of “monitor”	Monitor the Interamerican Development Bank Cadastre Registry project, offer support and follow up with a “show-up or shut-up” law.	Low	Long term

COLLATERAL

No.	Type	Recommendation	Priority	Duration
1.	Legal Reform	Promote legal reform such as expedited extra-judicial foreclosure procedures for commercial bank pledges (foreclosures through “sworn” brokers or <i>corredores jurados</i> rather than by courts).	High	Long term
2.	Legal Reform	Modernize secured lending law in Costa Rica and Central America in the nearest possible future.	High	Short term
3.	Legal Reform	Enact factoring legislation.	Medium	Long term
4.	Institutional Reform/ Automated Processes	Reform key regulatory policies, such within the Superintendence of Banks to require a 10% capital adequacy ratio in relation to assets (mostly loans) leading to a greater emphasis on high-quality (liquid) collateral (meaning collateral endowed with effective and up-to-date notice to other secured creditors and bona fide purchasers by means of an electronic commercial registry and susceptible to being converted into cash quickly and inexpensively).	Medium	Long term

No.	Type	Recommendation	Priority	Duration
5.	Institutional Reform	USAID and other donors should work with the Costa Rican public and private sectors representatives who participated in this Report and with the National Law Center for Inter American Free Trade to create a Central American entity whose function will be, among others, to research the best method of creating and enacting the new uniform law of secured transactions for the region.	Medium	Long term

COMMERCIAL DISPUTE RESOLUTION

No.	Type	Recommendation	Priority	Duration
1.	Training/ Education campaign	Place a priority on educating businessmen and attorneys about the benefits of alternative dispute resolution.	High	Medium term
2.	Legal Reform	Amend the alternative dispute resolution law to allow non-Costa Rican lawyers to act as arbitrators (which will provide comfort to potential foreign investors).	Medium	Short term
3.	Legal Reform	Service of process should be better carried out and regulated, particularly as it concerns service outside of the original trial district, in order to remove one of the delays in the judicial process.	Medium	Short term
4.	Translation	Make available English translations of Costa Rican laws affecting trade and commerce to assist non-Costa Rican attorneys and businesses (especially small and medium-sized businesses and the attorneys who advise them) who might consider exploring business opportunities in Costa Rica if they could more easily understand the legal environment.	Low	Short term
5.	Legal Profession Reform	Greater regulation of attorneys, including a functioning bar association to enforce ethical standards, and a more developed system of legal education which could include a bar examination and continuing legal education.	Medium	Long term

BANKRUPTCY

No.	Type	Recommendation	Priority	Duration
1.	Harmonization	When becoming a free trading nation, Costa Rica cannot retain a highly nationalistic approach to the bankruptcy of whatever merchant or company happens to find itself in Costa Rica. The present tendency among trading nations is to stop discriminating against foreign creditors and grant them national treatment (i.e., with the same treatment accorded nationals in Costa Rica).	High	Short term

No.	Type	Recommendation	Priority	Duration
2.	Legal Reform	Insolvent debtors should be given the opportunity to rehabilitate themselves by Chapter 11 types of proceedings. Mexican bankruptcy law has been recently rewritten and provides a good model for Central America.	High	Medium term
3.	Legal Reform	Bankruptcy law must be made consistent with secured transactions law. A uniform treatment of secured creditors in the Central American region requires a uniform determination of whether perfected security interests can succeed in retrieving collateral from the bankrupt's estate, or whether secured creditors are downgraded to the status of unsecured creditors once an act of bankruptcy occurs.	High	Long term
4.	Legal Reform	In the case of financial institutions shotgun marriages or <i>salvataje</i> should be allowed to proceed at the discretion of sound supervisors of the financial entities.	Medium	Medium term
5.	Legal Reform	There is a need for professional interventors and curators, i.e. officials or private sector specialists who are highly familiar with the business of the troubled enterprise.	Medium	Long term
6.	Training	Judges should be given better training on the meaning and consequence of sound asset management, and greater powers to detect and reverse fraudulent conveyance of assets.	Medium	Long term
7.	Harmonization	Much would be gained if a uniform, regional bankruptcy law were to be adopted under the guidance of the World Bank's recently drafted principles and best practices of insolvency regulation. These principles have been drafted by some of the world most respected experts on bankruptcy law, and practice and their adoption would automatically insure an improved credit rating for the Central American nations.	Medium	Long term

COMPETITION LAW

No.	Type	Recommendation	Priority	Duration
1.	Analysis	With a view towards convergence with international best practice (as formulated by the International Competition Network, OECD and others), review national legislation, and propose specific amendments to improve it.	High	Short term

No.	Type	Recommendation	Priority	Duration
2.	Resource Allocation – Institutional Strengthening/ Training	Improve and use the work of COPROCOM:	Medium	Long term
		<ul style="list-style-type: none"> • Increase efforts to allocate additional resources to COPROCOM via a twofold strategy: educational tools for the legislature on the benefits of competition law, and by building awareness of the shortage of resources among stakeholders (chambers of commerce, associations, consumer organizations, etc.) 	Medium	Long term
		<ul style="list-style-type: none"> • Elaborate and improve COPROCOM's staff manuals and private sector guidelines, particularly in areas such as analyzing anticompetitive conduct and mergers, competition law in regulated sectors, and the treatment of confidential information. 	Medium	Long term
		<ul style="list-style-type: none"> • Conduct training for agency staff in investigation techniques and analysis of competition cases, in particular in regulated sectors such as telecommunications, insurance, financial services, transportation and intellectual property. Training should be conducted through long term internships in more experienced agencies, or through the engagement of a long term advisor. 	Medium	Long term
		<ul style="list-style-type: none"> • Supplement advocacy initiatives with concrete studies of competitiveness in Costa Rica. Prepare case studies of the decisions taken by COPROCOM and the impact of these decisions on the affected sector. 	Medium	Long term
		Equip COPROCOM and CNC with additional infrastructure, including better information systems and case handling software.	Medium	Short term
3.	Education	Improve knowledge regarding the benefits of and how to implement a competition law and policy:		
		<ul style="list-style-type: none"> • Hold week-long training sessions for high-level judges with judges from more mature jurisdictions. 	Medium	Long term
		<ul style="list-style-type: none"> • Develop training sessions for sectoral regulators as well as for public sector personnel involved in government procurement. 	Medium	Long term
		<ul style="list-style-type: none"> • Increase the number of competition policy related courses at the university level, including training a sufficient number of Costa Rican academics, so that Costa Rica can serve as a regional training center for Central America. One way to do this is through exchanges between Costa Rican and foreign university professors. 	Medium	Long term

INTERNATIONAL TRADE

No.	Type	Recommendation	Priority	Duration
1.	Harmonization/ Funding	Donating agencies worldwide need to make a concerted effort to assist the Central American countries to make the necessary changes to implement CAFTA. Costa Ricans, who are by far the wealthiest of the region, have expressed that there truly are no funds in the country to make all the changes that need to be made to implement CAFTA.	High	Long term
2.	Legal Reform	There is no trade if local companies cannot buy and sell. For there to be trade it is essential to finance companies through the facilitation of commercial credits at low rates of interest. To provide lower rates of interest, risks need to be lowered. To do this, it is essential to improve the laws relating to the provision of collateral in Costa Rica, create a registry of debtors and collateral, among other things (see the collateral section of this report).	High	Long term
3.	Harmonization	It is necessary to encourage the Costa Rican government and Costa Rican Customs, as well as the countries of the region, to proceed with implementation of the customs union. The CACM countries also need technical assistance to improve inter-connectivity among customs services and the exchange of documentation and information (see section on Goods and Services as well).	High	Medium term
4.	Legal Reform/ Institutional Reform	An efficient, well staffed, trained, dynamic Customs Service is absolutely essential to ensuring free trade. The problems in Customs, including lack of training, lack of funds, corruption, lack of infrastructure, lack of risk analysis systems and targeting methodology, need to be addressed. Improvements in this area should help to speed up the clearance process, reduce opportunities for corruption, help deter smuggling, help stop drug trafficking and terrorism, and generally promote a healthy trading environment. In addition, there needs to exist a strong, efficient and functioning judicial review system of customs decisions (for example regarding the classification or valuation of merchandise, or whether it meets the CAFTA rules of origin). This may discourage corruption among customs service officials. In addition, Costa Rica needs to enact and enforce civil and criminal penalties for violation of customs laws, that will truly deter unlawful activities, including corrupt practices, smuggling, importation of counterfeit or pirated goods, drug trafficking, etc.	High	Long term

No.	Type	Recommendation	Priority	Duration
5.	Increased Awareness and Participation	The private sector needs to become more involved in the process of training customs officers (for example on how to detect counterfeit or pirated goods, how to correctly classify goods). Also, the private sector needs to be more active with their legislative assembly, by providing comments on draft legislation, presenting proposals for modernized laws, etc. Finally, the private sector needs to be willing to change. Many companies are used to doing business within the current trading environment, benefiting from many of the faults in the system, and this, while it has kept them in business, will not allow the country or the region to grow. Costa Rica needs to pass from being a country of family-oriented businesses, to competitive, modern businesses, willing to improve themselves to be able to compete with foreign producers.	Medium	Long term
6.	Harmonization	It is necessary to encourage regional solutions to problems in the trade facilitation, investment and customs area. It is necessary to provide technical assistance in certain areas on a regional basis, such as the establishment of a regional customs school, improvement, funding and implementation of the regional dispute resolution systems, among others.	Medium	Long term
7.	Alternative Dispute Resolution	It is essential to encourage the use of alternative dispute resolution methods, both for domestic disputes as well as for disputes between nationals and foreign companies. An efficient system of dispute resolution is beneficial to trade because it grants foreign investors more security, it allows merchants to focus their resources and time in promoting trade and competitiveness and not in endless and costly legal processes.	High	Long term

FLOW OF GOODS AND SERVICES

No.	Type	Recommendation	Priority	Duration
1.	Analysis/ Strategy Development	Develop and implement Border Inter Agency plan for Harmonization and Simplification of Procedures	High	Long term
2.	Analysis/ Strategy Development	Develop and implement a Customs and Trade Partnership Program to promulgate cooperation, information exchange and consultation for policy and procedural simplification and standardization.	Medium	Long term
3.	Analysis/ Strategy Development	Institute a media promoted anti-corruption campaign to solicit public reporting of official abuse of authority and publicize successes.	High	Long term

No.	Type	Recommendation	Priority	Duration
4.	Process Re-engineering	Further develop risk management controls and institute compliance measurement techniques using scientifically based methodologies to conduct physical and documentary inspections.	Medium	Long term
5.	Legal/Financial	Identify alternate means of funding to promote Customs Modernization, upgrade officer working conditions and equipment, and provide incentives for quality performance.	High	Medium term
6.	Process Re-engineering	Develop commodity specialization and reorganize core process to effectively utilize officer expertise to address complex free trade issues.	Medium	Medium term
7.	Systems/Equipment	Develop a coordinated donor plan to establish a properly equipped training facility and library of training materials and resources.	Medium	Medium term
8.	Systems/Equipment	Continue to support development and implementation of Customs new automated system - TIC; identify additional funding sources and promote other agency integration into system.	Medium	Long term

FLows OF PEOPLE & TRADE-RELATED FINANCE

No.	Type	Recommendation	Priority	Duration
1.	Institutional	<p>Improve access to credit for small and medium-sized exporters and importers. While the basic tools for conducting exchange of payment for trade exist (i.e., letters of credit), trade and financial institutions must develop strategies to more effectively extend credit to reliable small and medium-sized traders. A robust trading system provides small and medium-sized traders with the ability to finance their export and import activities, yet the current system often requires many smaller traders to self-finance their activities. This reality imposes serious costs on importers and exporters making them less competitive. Strategies to pursue, include such activities as:</p> <ul style="list-style-type: none"> ▪ establishing guarantee funds that offer credit to exporters for fewer guarantees than currently demanded; ▪ developing associations/cooperatives among producers for pooling of resources and risks to acquire lower cost credit; increasing importers and exporters understanding of existing bank instruments through seminars and training. 	Medium	Long-term

FINANCIAL CRIMES

No.	Type	Recommendation	Priority	Duration
1.	Institutional Strengthening/ Strategy Development	Costa Rica has formally complied with basic international standards on money laundering. In practice, however, there are problems. Even as suspicious financial transactions are identified, those charged with enforcement seem unable to investigate adequately. In order to rectify this, efforts should be made to ensure coordination and cooperation among the various bodies that deal with financial crimes.	High	Near term
2.	Institutional Strengthening/ Strategy Development	Despite training from US agencies, the Costa Rican money-laundering authorities do not seem to be getting the cooperation they need from agencies in the US. US agencies should address communications and coordination problems.	High	Medium term

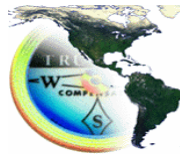
INFRASTRUCTURE

No.	Type	Recommendation	Priority	Duration
1.	Analysis/ Strategy Development	Conduct a national transportation market demand study across relevant modes. This study should include a gap analysis that quantifies future demands from both an infrastructure constraint perspective and an unconstrained perspective.	Medium	Medium term
2.	Analysis/ Strategy Development	Conduct a detailed existing and future transportation corridor analysis to establish both near- and long-term infrastructure needs required to accommodate projected transportation demands. This analysis should include an assessment of existing component infrastructure conditions, operations, and capacities, a projection of future operating goals and volume demands, present a detailed cost/benefits analysis of infrastructure development versus operational expansion under both existing and alternative infrastructure improvement scenarios, and establish a set of national development priorities based on identification of balanced integrated multi-modal transportation system	High	Medium term

No.	Type	Recommendation	Priority	Duration
.	Analysis/ Strategy Development	Develop a set of individual component transportation infrastructure (roadways, seaports, airports, etc.) strategic development plans that systematically meets the priorities and objectives of the national development plan. These strategic plans should encompass the business requirements of individual transportation modes while meeting the needs of the overall national plan.	High	Medium term
4.	Analysis/ Strategy Development	Evaluate the benefits of private sector operations and investment in infrastructure development to both expedite realization of necessary improvements and alleviate financial burdens on existing implementing institutions.	Medium	Medium term
5.	Legal/Financial	Establish legal autonomy for individual infrastructure implementing institutions to establish revenue requirements and set corresponding tariff structures to realize revenues required for capital development, as well as to execute capital plans as required in their strategic development plans.	Medium	Long term
7.	Legal/Financial	Identify mechanisms and demonopolize existing electrical and telecommunications authority to realize future service enhancements and corresponding competitive rate structures. Consider private sector involvement.	High	Long term
8.	Process Re-engineering	Minimize government involvement in approval and execution of strategic infrastructure development initiatives as outlined in implementing institutions' strategic development plans.	High	Medium term
9.	Systems/ Equipment - Roadways	Establish national design criteria for transportation infrastructure that is based on international best practices and appropriate levels of service goals to reduce bottlenecks, potential for accidents, and improve overall traffic flow under peak conditions.	High	Short term
10.	Systems/ Equipment - Seaports	Deploy dedicated landside discharge and load equipment (cranes, bulk unloaders, etc.) to improve productivity and utilization of existing fixed seaport assets (i.e., berths). Develop on-dock container storage facilities to reduce container handling and private-sector drayage costs while realizing new revenue sources. Focus future development and Puerto Moín and establish a dedicated freight corridor outside the city of Limón to eliminate vehicle traffic conflicts.	Medium	Long term
11.	Systems/ Equipment – Airports	Maintain existing development initiatives for the major international airport. Identify and implement landside access improvements to eliminate vehicle traffic conflicts (i.e. passenger versus air cargo). Establish goals to increase air operations serviceability at Liberia through expansion of the existing runway.	High	Medium term

No.	Type	Recommendation	Priority	Duration
12.	Systems/ Equipment – Border Crossings	Develop and deploy organized, purpose-built border crossing gates of sufficient capacity and appropriately staffed to accommodate peak vehicle flows in an efficient and orderly manner.	Medium	Short term
13.	Systems/ Equipment – Electrical/ Telecom/ Internet	Seek private sector investment in infrastructure to further enhance overall system capacity and reliability as required by consumer demand.	High	Long term

ATTACHMENT 2: ROUNDTABLE PACKAGE



Preparing for CAFTA and Regional Harmonization Trade, Commercial Law and Institutional Development Strategy Roundtable Discussion

June 3, 2004 • 14:00 – 18:00
Costa Rica Marriott Hotel • San José, Costa Rica

Agenda

2:00 – 2:30 **Opening Remarks**

- Agenda Overview: James Michel, Assessment Team Member
- Welcome and Overview of Regional Harmonization Efforts: Roberto Echandi, COMEX
- Overview of CAFTA Assessment Activity: Jim Stein, USAID/G-CAP

2:30 – 3:15 **Session I: Presentation of Trade and Commercial Law Assessment Findings**

- Overview of Commercial Law Findings: Boris Kozolchyk, Assessment Team Member
- Overview of Customs/Trade Findings: Irina Swift, Assessment Team Member
- Local Expert Perspective: Carlos Echeverría, Attorney

3:15 – 3:30 **Coffee Break**

3:30 – 5:15 **Session II: Focused Group Discussions**

- Breaking Down Trade Barriers
- Fostering Healthy Credit Systems
- Strengthening the Quality and Standards of the Trade Community
- Increasing Participation in the Lawmaking and Regulatory Process

5:15 – 5:45 Breakout discussions presentations

5:45 – 6:00 **Wrap up and Closing**

6:00 – 7:00 **Reception**

Breakout Discussion Topics

Breaking Down Trade Barriers

- What are the major obstacles to trade across borders? What are the major obstacles to doing business in Costa Rica?
- What are some solutions to reducing or eliminating bottlenecks you have identified?
- What are the impediments to implementing these solutions?

Fostering Healthy Credit Systems

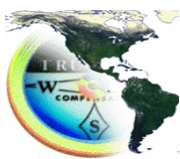
- What are the major obstacles to improving the credit system so that it will attract substantially increased levels of commercial finance?
- What are some solutions to overcome these obstacles?
- What are the impediments to implementing these solutions?

Strengthening the Quality and Standards of Trade Intermediaries

- In what ways do intermediaries impede trade?
- How can these intermediaries provide services that better facilitate trade?
- What are the impediments to implementing these improvements?

Improving Interaction between the Private and Public Sectors (Omar/James)

- What are the obstacles to more effective business involvement in the formulation of policies, laws, and their implementation?
- How can these obstacles be overcome?
- What are the impediments?



Conclusions/Recommendations
Preparing for CAFTA and Regional Harmonization
Trade, Commercial Law, and Institutional Development Strategy
Roundtable Discussion
Hotel Costa Rica Marriott, San José, Costa Rica
June 3, 2004

Group 1 – Breaking Down Trade Barriers

Issues

- There exists a lack of communication and coordination among relevant public entities.
- Insurance/risk analysis is complicated for customs, with respect to the movement of goods.
- The system for the movement of goods could be more easily facilitated, e.g. through more computerized/automated processes.
- Customs officials are generalists and not permanent; specialists would be better
- Bureaucrats resist making change to excessive controls they have imposed; a change in mentality is in order.
- The infrastructure is deficient.
- The agencies that control competition policy and protect against financial crimes need a stronger legal framework.

Recommendations

1. Strengthen and develop relevant institutions: promote specialization among employees.
2. Improve infrastructure – from roads and ports to computerization of processes through strengthening of concessions of public works.
3. Develop training programs to achieve greater efficiency and changes in mentality with respect to commerce; increase familiarity with technical regulations, and laws.
4. Greater investment by the state in concessions of public works.
5. Establish mechanisms of communication not only between government agencies but also between public, private, and civil society sectors as problems exist within and between them all.

Group 2 – Fostering Healthy Credit Systems

Recommendations

- The processes within the registries permit too much discretion and opinion so it lacks predictability. Reform is needed to correct this, though no suggestions on what kind of reforms.
- Lessen the degree of formalities within the registries so that there is not a “puritanical” following of requirements which lead to unnecessary delays.
- Allow for greater ease in the registration of different ways of securing credit, such as values associated with contracts, futures, non-movable goods, other collateral.
- Align fees for registration and notaries to a sliding scale – e.g. someone securing a transaction worth one dollar should not pay the same fees as one worth one million dollars; participation of notaries in registration processes is expensive (average 4-5% of value) and excessive.
- Improve the process of registration/completion of large value assets transfers, and further facilitate the transfer of assets by creating regular vehicles to handle the process, and reforming remittance taxes on these transactions.

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- Changing the mindset and ‘dogma’ surrounding notaries – despite their importance they often do not in fact add to the reliability or security of a contract.
 - Introduce transparency into banking records as private banks are not obliged to reveal information on performance (this is an issue recently decided by the Supreme Court of Costa Rica where it was found that banks should reveal this information, but this decision has not yet been followed). This would introduce greater efficiency into the system.
 - Employ more aspects of the model law on secured transactions of the Organization of American States.
 - Improve the performance of credit bureaus and the financial system through better reporting and histories of credit.
 - Improve the capacity of Registries to transfer assets with large amounts.

Group 3 - Strengthening the Quality and Standards of Trade Intermediaries

Recommendations

- Establish universal computer systems to ensure greater control of sales, collection of taxes, etc, and reduce costs.
- Make uniform accounting process for all size businesses, and penalize non-compliance.
- Ensure that associations, chambers of commerce, industry, brokerages etc., have accurate and sufficient knowledge of relevant regulations; establish system for continuing education for professionals.
- With regard to the land cadastre, employ greater protections against fraud in property deeds, false names and notarial stamps.
- Ensure that Brokerages have accurate information of the properties being purchased
- Transactions costs, e.g. for notaries, are high, and should be made proportional and regular with respect to the value of the transaction.
- Regularize the transaction processes with respect to property so as to ensure adequate “good faith,” security of information regarding the property, and regularization of the system, both within Costa Rica and throughout the region. Legislation to do this was being considered within Costa Rica but has been tabled.
- Creation of government supervised oversight boards composed of domestic and international professionals to promulgate the professional ethical and operating standards applicable to each profession. Require all licensed individual professionals and their firms to register with the oversight board, and prohibit all unlicensed individuals and their firms from holding themselves to the public as professionals.
- Establish guidelines for mandatory continuing educational courses. These courses should be designed to help improve individual professional competence, encourage adherence to high professional ethical practices, and promote interaction with international professionals.

Group 4 - Improving Interaction between the Private and Public Sectors

Recommendations

- Communication between government and private sector stakeholders is not well established or used at local, executive, and legislative levels. Government officials are not perceived as receiving input from the private sector. The private sector should have regularized and consistent access to government officials.
- Assist private sector in improving coordination within the private sector; assist chambers of industry to improve efforts to track government activities (note: The Ministry of

Foreign Trade is an exception to this). In this connection, there needs to be great coordination within the private sector itself.

- State institutions need to be in sync with the changes in the productive sector, e.g. the direct and rapid effect of technology must be accounted for.
- Foster best practices in coordination efforts, public outreach and participation, etc. government agencies. Take best qualities and practices of the most successful government agencies and foster those qualities and practices throughout the government.

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